



# Annual Report 2014

Central Bank of  
Solomon Islands



The Central Bank of Solomon Islands logo is the "BOKOLO" a hand carved fossilized clam shell once used as currency in Western part of Solomon Islands



## VISION, MISSION, AND VALUE STATEMENTS

### VISION

Solomon Islands to be amongst the top 4 low inflation and financially stable countries in the South Pacific region.

### MISSION

Our mission is defined by Section 8 of the Central Bank Act 2012 in the following priorities:

- To achieve and maintain domestic price stability;
- To foster and maintain a stable financial system and
- To support the general economic policies of the Government.

### VALUE

We are committed to uphold the following values:

- To provide quality economic analysis and assessment of the Solomon Islands economy to enable our stakeholders to make informed business judgements and decisions;
- To discharge our duties with integrity and honesty;
- To show excellence and professionalism in our work;
- To act with impartiality in the application of our decisions within the boundaries of the CBSI Act or any other laws we administer; and
- To exercise frugality in the management of the resources under our stewardship.

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April 2015

Hon. Snyder Rini, MP  
Minister of Finance & Treasury  
Ministry of Finance & Treasury  
P.O. Box 26,  
Honiara

Dear Minister,

**Re: 2014 Annual Report and Financial Statements**

In accordance with Section 58(2) of the Central Bank of Solomon Islands (CBSI) Act 2012, I submit to you the CBSI annual report, together with the annual accounts for the twelve months period ending 31st December 2014.

Yours Sincerely;



**Denton Rarawa**  
Governor



## GOVERNOR'S FOREWORD



The Governor, Denton Rarawa

2014 was a real test-year for the Solomon Islands economy. The flash floods in early April not only devastated the economy, especially on Guadalcanal and Honiara, but also led to the closure of Gold Ridge mine. A year on and the mine still remained closed. The impact of the natural disaster and ensuing downturn in the economy severely tested the resilience of the people of Solomon Islands. Local and international commentators predicted that the country would contract in 2014. Forecasts were for the economy to record zero to negative growth. Again, Solomon Islanders rallied and their resilience proved those predictions inaccurate. This happened before, after the social unrest in 2003, again after the global financial crisis in 2009 and I am sure it will happen again in the future. This is a unique strength of our economy that should be enhanced and nurtured. It is an important characteristic of our people that should be recognized and built on. This resilience had and will continue to sustain our families, communities and the country as a whole.

### Highlights in 2014

The economy recorded growth of 2.0% in 2014, down from the 3.7% pre-flood forecasted growth for 2014 and 2.8% in 2013.

Inflation that soared after the floods peaked at 7.2% around July before receding to 4.8% in December 2014. This downward movement in inflation was driven by the fall in international fuel and food prices. At this level, the aim for Solomon Islands to become one of the low inflation countries in the Pacific region is still on course. It is also encouraging to see work has started on compiling a national CPI for the whole country rather than just for Honiara as is the current situation.

In terms of the Bank's operations, 2014 again proved to be another challenging year. Despite these challenges, there were positives that can be pointed to, but at the same time, there were also negatives.

As in 2013, the Bank again recorded revaluation losses in 2014 as a result of movements in the exchange rate, lead-

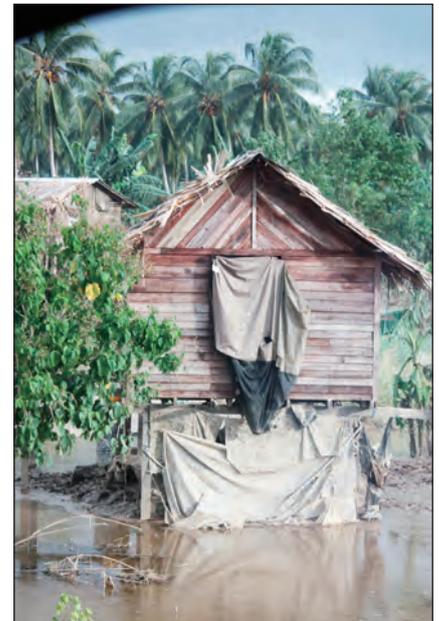
ing to further erosion of the capital base and drain on the gross international reserves.

The Bank bore the brunt of the movements in the exchange rate, but never in the history of the country had Solomon Islands been in the current situation where the exchange rate movements have benefited both exporters and importers at the same time.

In the financial inclusion space, considerable gains were made. Last year the country achieved its goal of enabling an additional 70,000 new bank customers have access to financial services and products. The commercial banks' successful roll-out of branchless and mobile phone banking services and products was the major driver behind this success story. For the Bank, financial inclusion has become an important component of its financial stability mandate.

Financial deepening continued with the opening of Pan Oceanic Bank (POB) for business and the licensing of new insurance companies, Pacific Assurance Group and Capital Insurance Group.

Excess liquidity in the banking system still remains high. There was renewed credit growth in 2014 especially in the second half of the year but these went to Honiara based activities and mostly to the consumption sector. Appropriate policies that encourage and support private sector investments not only in Honiara but more importantly in the provinces need to be put in place. Additional initiatives to promote micro and small medium enterprises (MSME) that create job opportunities also need to be introduced.



A house is surrounded by water from the heavy flooding in Honiara on 7 April. Many homes along the Mataniko River bank were destroyed and the only gold mine in the country was closed with dampening effect on the economy.

### Outlook for 2015

The outlook for Solomon Islands in the near term remains positive. The economy is expected to be more buoyant in 2015 than last year. Economic growth is anticipated to rise in 2015 to 3.2% from 2.0% in 2014 with the key drivers

being the primary sector especially fish, agriculture and bauxite, while logs are expected to subside following the significant rise in 2014.

The DCC Government has embarked on fundamental and sectoral reforms aimed at positioning the country on a future growth trajectory. The Bank fully supports the Government's policy objectives to achieve higher levels of growth in the economy.



Staff of Westpac Bank march towards the Art Gallery to participate in the first ever financial inclusion expo in Honiara in June 2014. In 2014 commercial banks opened over 78,000 new bank accounts for Solomon Islanders and established 538 access points using new branchless banking channel as part of the financial inclusion policy goals. Photo by Gane Simbe

It is important that the Government remain focused on its agenda and implement its announced policies and plans, and avoid being distracted by other peripheral issues.

It is also important that resource owners heed the Governments' call to free up their resources for the development of the country.

Finally let me acknowledge and thank the many organizations, government agencies, stakeholders and individuals that supported the Bank in 2014. Your support has enabled the Bank to perform its roles and functions and achieve its many mandates during 2014. Let me also acknowledge my Board for their guidance, advice and direction on policy matters during the year.

Lastly but certainly not the least, to my senior Management team and all the Staff of the Bank, let me thank you for your professional contribution and dedication to the activities of the Bank in 2014.

Denton Rarawa  
Governor

## CHAPTER 1: OVERVIEW OF ECONOMIC DEVELOPMENTS IN 2014

The Solomon Islands economy showed a lot of resilience in 2014 to recover from the negative fallouts from the April floods and the closure of Gold Ridge mine in the second quarter. Growth for 2014 was revised upward from the April projection of 0.9% to 2.0% but was down against pre-flood projection of 3.7%. The improvement against the past flood projection was due to significant improvements in key non mineral sectors combined with the swift expenditure adjustments both from the national government and its development partners. Favourable external developments in particular rising prices for major export commodities and falling energy prices later in the second half of the year also supported the economic recovery.

### INTERNATIONAL DEVELOPMENTS

The global economy grew by 3.3% in 2014, the same pace as the previous year despite mixed trends across the different countries. The positive overall outturn reflected sustained growths in the advanced economies as well as the emerging markets and developing economies. World trade expanded further by 3.1% following the 3.4% growth in 2013. The lesser growth in 2014 reflected slowing demand from emerging markets and developing economies. Import demand from the advanced economies however remained upbeat.

Activities in the advanced economies picked up slightly to 1.8% in 2014 compared to 1.3% a year ago. Leading the charge were United States, United Kingdom, Canada and other advanced economies<sup>1</sup> with growths above 2%. The US economy, which recovered quickly from a contraction in the first quarter of 2014, registered a growth of 2.4%. This was higher than anticipated and consolidated the 2.2% growth in 2013. Unemployment had fallen further while inflation remained low as a result of the appreciation in the USD and weak oil prices. United Kingdom and Canada recorded even higher growths than the previous year at 2.6% and 2.4% respectively. Steady improvements in the major economies within the euro area helped to lift the euro area out of the previous year's recession to post a



Two men watch as a digger operator makes temporary road beside a bridge in West Guadalcanal that was destroyed by the flood in April. Photo by CBSI

growth of 0.8%. Activities in the Japanese economy on the other hand shrunk substantially to almost zero growth of 0.1% due to unanticipated negative responses in private domestic demand to a hike in consumption tax rate.

Emerging markets and developing economies grew by 4.4% with much of the impetus for growth originating from the Asian bloc. Growth in China may have dipped a little against the prior year due to weak investment activities in the third quarter but at 7.4%, China has the highest and is still regarded as an influential driver behind world growth. Growth in India picked up momentum to 5.8% and the ASEAN-5 was up by 4.5%.



Kakabona residents watch a group of men building a temporary crossing to connect West Guadalcanal to Honiara, after the flood in April. Many bridges in Central and West Guadalcanal were destroyed, including the old Mataniko bridge which was completely washed away by the flood and caused unbearable traffic congestions in Honiara. Photo by CBSI

In Australia, GDP growth was estimated at 2.8% due to strong growth in mineral exports boosted by robust consumption and investment spending. Planned reductions in the fiscal deficit provided little support for growth. In spite of the economic expansion, the unemployment rate rose to 6.1% in September 2014 and was the highest in just over a decade. The New Zealand economy also trended upward to 3.6% in 2014. Rising exports supported by strong private consumption and extensive investments in housing and construction were the main driving pillars behind the surging growth in 2014.

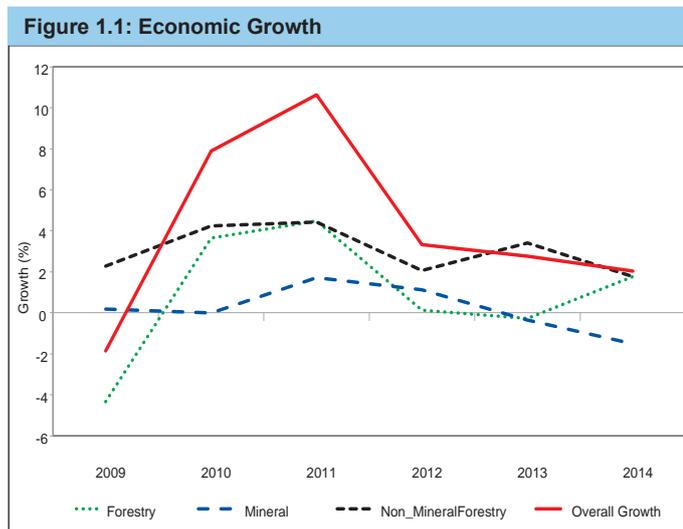
Based on recent developments, the outlook for the global economy was revised downward from the October projections to 3.5% for 2015 and 3.7% for 2016. The outlook was predicated on the different effects these recent developments - falling oil prices; marked growth divergence across major economies; appreciation of the US dollar against other major currencies; and rising interest rate and risk spreads in many emerging economies - may have on the global economy. While low oil prices provide stimulus for growth in non-oil exporting countries, oil exporting economies are likely to experience a fall in fiscal revenue and level of economic activities.

<sup>1</sup> Excludes G7 (Canada, France, Germany, Italy, Japan, United Kingdom and United States) and euro area countries.

Global inflation is expected to remain tame in 2015 at 2.0% compared to 2.6% in 2014. The downward trajectory reflects anticipated falls of 41.1% and 9.3% in energy and non-energy prices respectively. IMF projected consumer prices in the advanced economies to fall 0.4 percentage points to 1.0% in 2015. However, consumer prices are expected to move up in the emerging and market economies by 0.3 percentage points to 5.4%. The Reserve Bank of Australia forecasted inflation in Australia to fall in the first half of 2015 to 1.25% before tracking upward to within a range of 2.25% - 3.25% by end year. Reserve Bank of New Zealand anticipates headline inflation to be volatile given the uncertainty over oil prices but medium term inflation should be broadly at 2%.

**DOMESTIC DEVELOPMENTS**

Domestic economic activities performed much better than previously anticipated in April last year. Preliminary estimates from the CBSI pointed to an overall growth of 2.0% for 2014, 1.1 percentage points higher than the 0.9% CBSI projected in April 2014. All sectors except for mineral, manufacturing and utilities sectors recorded positive growths during the year. Surprisingly, logging activities jumped up significantly to a new unprecedented level during the year. This to a great extent temporarily cushioned the contraction in the mineral sector and boosted overall growth for the year supported by positive developments in agriculture, fisheries, communication, construction, and finance sectors.

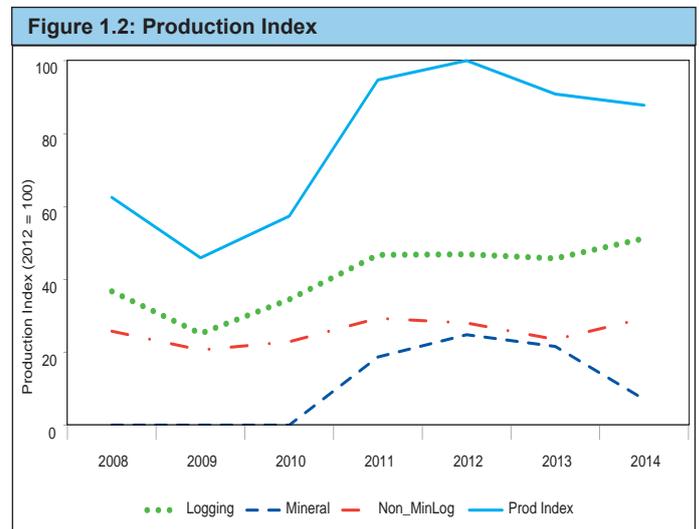


Source: CBSI

Leading indicators in the labour market showed modest growth in employment even though some industries found the year challenging. The mineral sector was the hardest hit with about 720 workers driven out of jobs after the closure of Gold Ridge Mining Limited in the second quarter. Industry consultations the Central Bank conducted earlier this year revealed most companies in the non-mineral sectors either retained their staff or employed a few more people despite the economic shocks in the sec-

ond quarter. This is consistent with trends in the number<sup>2</sup> of superannuation contributors that rose by 12% over the year to 53,796 people even considering the redundancy exercise in the mineral sector.

Production of key export commodities in the economy weakened further in 2014 owing in large part to the closure of the only gold mine in the country. As measured by the CBSI production index, the commodity sector fell by 4% against the previous year. The overall decline was driven by gold which plunged by 15.3% to outweigh the combined gains in the non-mineral index (see Figure 1b). The fall would have been more drastic if logging activities remained low at the same level as in the first half of 2014. Log production increased dramatically to 2,128,000 cubic meters from 1,897,000 cubic meters in 2013, a jump of 5.3 points over the year to 51.3 in the log index. Re-entry into previously logged areas, clear felling activities, and issuance of additional logging licenses contributed to the sharp escalation in the exported log volumes.



Source: CBSI

The balance of payments (BOP) position of the country deteriorated in 2014, due in part to the widening current account deficit and the revaluation losses the Central Bank incurred as a result of adverse exchange rate movements. The current account deficit of \$418 million recorded in 2014 represented 6.0% of GDP, a deterioration of 1.6 percentage points from the deficit in 2013. While the negative balances on goods and services showed relative year-on-year improvement, secondary income showed a worsening trend to underline the deterioration in the current account. However, the capital and financial account recorded a smaller surplus of \$481 million to sufficiently cover the current account deficit.

The appreciation of the United States dollar (USD) against other major trading currencies had significant influence over how the SBD behaved against other currencies. SBD was relatively stable against the USD in the first three

<sup>2</sup> Averaging the number of monthly contributors (active and slow active) in the fourth quarter. Active and slow active contributors are contributors that SINPF received contributions over the past twelve months from the reporting period.

quarters of the year except in the fourth quarter when a policy decision was made to allow the invoice weighted index of the basket of currencies to fluctuate. This policy measure was undertaken to realign the local currency and avoid large exchange rate adjustments in the future. This to some extent reduced the revaluation losses incurred particularly in the fourth quarter. Comparing to end December 2013, the local currency depreciated by 3.7% against the USD to \$7.63 in December 2014 with much of that depreciation experienced after the exchange rate policy review in October 2014. The CBSI also increased the bid offer rates CBSI imposed on the two major trading currencies USD and AUD in the fourth quarter to promote foreign exchange market development.



Exported round logs increased to contribute to the recovery of the economy after the closure of the gold mine in April as a result of flood and low gold prices. Over 2 million cubic metres of logs were exported in 2014, a new record volume. Photo CBSI file photo

Money supply expanded by 6% to \$3634 million in 2014, a much slower pace than the average growth of 15% in the previous two years. The slowdown was underscored by the negative turnaround in reserve money by 10% to \$1828 million. However credit to private sector picked up momentum in the third quarter to sustain a year on year growth of 16% in the final two quarters to \$1703 million by December 2014. Most of the credit went to personal loans which boosted private consumption both for domestic and imported goods. Other sectors recording increased borrowing during the year were communication, professional and other business services, distribution, manufacturing, and transportation sectors.

The Government suffered a major setback in 2014 following the devastation caused by the April floods and the closure of the Gold Ridge mine. Fortunately, development partners were quick to respond and the government with available fiscal space have cushioned the revenue shortfall and accommodated high unplanned expenditure pressures. These quickly restored affected infrastructures and minimised economic downtime. The Government recorded a fiscal surplus of \$129 million during the year from revenue collections of \$3121 million and \$2992 million in expenditures. The surplus was attributed to unexpected increases in revenue particularly from fishing licenses, increased budget support, and expenditure savings most

notably in the capital budget.

Headline inflation dropped consistently in the second half of 2014 to 4.8% and was in contrast to developments in the first half where inflation climbed up to a year high of 7.2% in June. The headline inflation was within CBSI's projected inflation range of 4% - 6% for the year. The inflation trend in 2014 reflected transitory negative supply shocks that kicked in immediately after the flash floods only to subside after June. In December 2014 the domestic price index receded to 8.0% while the imported index staggered at negative 0.2%. Falling food and energy prices in the second half were major drivers behind the deflation in the imported component.

## ECONOMIC OUTLOOK

The domestic economy is expected to be more buoyant in 2015 than the previous year. The interplay between key domestic sectors and global price trends is anticipated to support further recovery. Economic growth is anticipated to increase in 2015 to 3.3% from 2.0% in 2014. In the primary sector, the key drivers are fisheries and agriculture while logging is expected to subside after the significant jump in 2014. The mineral sector, in spite of positive contributions from bauxite exports, would still see a decline in 2015 with the absence of gold.



A forklift driver carts bags of copra into storage shade for export at the Solomon Islands Ports Authority's warehouse in Honiara. About 19,101 tons of copra were produced in 2014 due to better world market price. Photo by CBSI

External conditions are expected to improve slightly over the previous year despite expectations that the structural current account imbalance would remain in 2015. Budget support and donor capital inflows are expected to outstrip the current account deficit and boost gross foreign reserves. The export sector however could worsen on the back of anticipated declines from gold and log export receipts while imports are expected to rise modestly. Persistent falling oil prices gives temporary reprieve for the economy in terms of lower fuel import bills at least for 2015. Businesses and households are hoping that this positive development is translated into relatively cheaper util-

ity costs for the country.

Money supply could expand further by 8% against the previous year to \$3909 million in 2015. There is still a growing appetite for more lending activities both in the private and public sectors. The latter would be mainly to finance large pipeline projects. The establishment of the Credit Bureau in 2014 is expected to encourage credit growth as more information about potential borrowers becomes available to financial institutions.

The newly elected Democratic Coalition for Change Government has unveiled its policy priorities for the next four years in January 2015 with an emphasis to grow the economy through the creation of investment opportunities in manufacturing and industry developments across various sectors in an environmentally sustainable way. Consistent with the policy intention to develop the rural economy, the government planned an expansionary fiscal budget of \$4183 million in 2015 with about 68.5% of capital expenditures channelled to rural development, infrastructures and services sectors. The 2015 budget is expected to be financed from domestic revenue of \$2850 million, \$863 million in aid grants from development partners and accumulated budget savings from previous years of \$470 million.



Yellow fin tuna are sorted into boxes before taken for processing at SolTuna Limited's processing factory at Noro, Western Province. SolTuna processed loins that were exported to markets in Europe and United States. Most of its canned products were sold in Solomon Islands and in neighbouring MSG countries. Photo by Gane Simbe

Inflation is projected to decline further in 2015 to within a lower range of 3-5 percent from the 4-6 percent range in prior years. This is in view of expectations that energy and food price pressures would remain subdued against the previous year. The low oil prices are expected to pass-through into the local component via falling input costs on a quarterly basis. Additional benefits are also anticipated from the planned review of the tariff on electricity by Solomon Islands Electricity Authority and the Government in the first half of 2015. While factors such as the fiscal deficit and depreciation of the local dollar against

USD could pose upward inflationary pressures, the Bank anticipates the latter would be mitigated by anticipated larger falls in oil prices.

In this small economy, the Government has a big role to play in determining the development path of the country. With the developments in 2014 as the background, there is a need to revamp the economy with an expansionary budget. However, it is equally important that these limited resources are properly invested in projects that provide high and long term economic gains to the country. Raising and sustaining a higher public investment to GDP ratio over and above the current level of less than 20% can help create support infrastructures for other sectors to thrive and drive future growth. Occurrence of high incidences of fraudulent activities within the public sector is a costly tax on the economy and must be weeded out. The public sector must adhere to good financial and procurement practices to stem out corruption and minimise wastage of public resources.



Construction workers working on the foundation of a new shopping complex next to Honiara main market in 2014. Lending to Construction/Housing industry increase by 23% in 2014 and Honiara City Council issued 213 construction permits during the year which represent pipeline projects in 2015. Photo by Gane Simbe

In 2015, the Central Bank remains committed to its price and financial stability objectives. The Bank plans to conduct further reviews on the monetary and exchange rate policy frameworks to enhance policy implementation and create a macroeconomic environment conducive for the Solomon Islands economy to thrive. The Bank recognises that in order for these policy frameworks to work effectively, the CBSI will have to strengthen its equity capital base with the assistance of the government. Further to that, the Bank plans to pursue ongoing legislative reforms in 2015 and this includes the National Payments Systems bill, the SINPF bill, Credit Union bill, and Insurance bill. These legislative reforms will require concerted efforts from all stakeholders, including the National Govern-

## CHAPTER 2: GOVERNANCE AND ORGANISATION

### Corporate Governance

The governance and the organization of the CBSI are vested in the Board of Directors that are appointed under Sections 38(1) and 41(2) of the CBSI Act 2012. Board members are:

- the Governor, as the chairperson
- Deputy Governor;
- The Permanent Secretary, Ministry of Finance & Treasury; and
- Six non-executive directors.

The Board of Directors are charged with the formulation and supervision of the implementation of the CBSI policies; and supervision of the administration and operations of the Bank.

Directors for 2014 are Mr Denton Rarawa, Governor and Chairperson; Mr Gane Simbe, Deputy Governor and deputy Chairperson; the Permanent Secretary of the Ministry of Finance & Treasury (MoFT); Mr Shadrach Fanega (up to mid-October), Mr Fred Fakarii (from mid-October) as ex-officio director. The six non-executive directors are; Mr Katalulu Maepioh, Mr Loyley Ngira, Mrs Lilly Lomulo, Mrs Tele Bartlett, Mr Primo Afeau and Mr. John Usuramo.

Mr. Shadrach Fanega, who was an ex-officio director on the Board for about 14 years, ended his term after he was transferred to head the Ministry of Development, Planning and Aid Coordination. The Bank would like to thank Mr Fanega for his valuable contributions to Board decisions. During his term he never missed a meeting unless he was overseas and his active participation during meetings greatly assisted the Bank in the finalisation of many of its policies. In the same tone, the Board also, warmly welcomed Mr. Fred Fakarii as the new PS of MoFT and new ex-officio director on the Board and looks forward to his valuable contributions to Board deliberations.

### Board Meetings

The Board held ten meetings during the year, 4 more than the minimum of 6 meetings required under the CBSI Act. There was no provincial meeting held during the year. The table below shows the numbers of meetings each Director attended in 2014.

| Director Name    | Number of Meetings attended |
|------------------|-----------------------------|
| Denton Rarawa    | 10                          |
| Gane Simbe       | 8                           |
| Shadrach Fanega  | 7                           |
| Katalulu Maepioh | 10                          |
| Loyley Ngira     | 8                           |
| Lilly Lomulo     | 8                           |
| Tele Bartlett    | 6                           |

|              |    |
|--------------|----|
| Primo Afeau  | 7  |
| John Usuramo | 10 |
| Fred Fakarii | 3  |

Source: CBSI

### Board businesses

In 2014 a total of 46 Board papers were submitted for Board deliberation, 5 more than in 2013. Of the total, 27 papers were quarterly progress reports for noting; and 19 were policy papers for Board decisions. These policy papers included two bi-annual Monetary Policy Stance documents, the 2013 Annual Report and the 2013 Audited Financial Accounts, revision to the Gold Policy on investments, Prudential Guideline No 9, Legal services policy, review of the administration of the Exchange Rate, Pan Oceanic Bank banking licence, establishment of banking relationship with Bank of China Hong Kong, Charters Traders Bank Limited application for Banking licence, the 2015 Business Plan and 2015 Budget and the review of Exchange Rate margin.

### Board Committees

There are three Committees that were set up to assist with the governance and management of the Bank. The Committees are; the Board Audit Committee, the Board Staff Remuneration Committee and the Board Disciplinary Appeal Committee.

### Board Audit Committee

The Board Audit Committee was established at the end of 2010. The Committee has four members; three non-executive Directors, the Deputy Governor and the Manager of Internal Audit Unit who is Secretary to the Committee. One of the Non-executive Directors is appointed by the committee members as the Chairperson of the Committee.

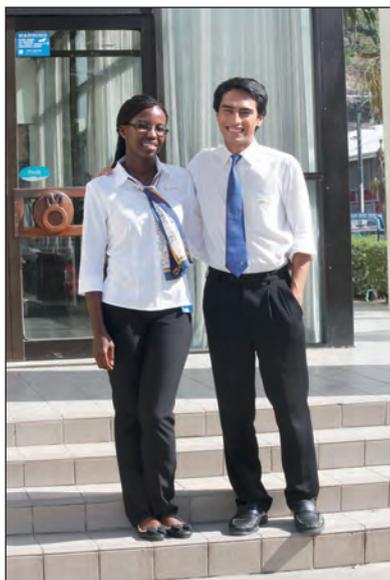
The Chairman of the Board Audit Committee reports to the Board after each meeting. In 2014, the Board Audit Committee met four times as planned for the year. The Board Audit Committee provided feedback to the IMF on matters required to ensure the Bank meets the IMF Safe-guard Assessment standards.

### Board Staff Remuneration Committee

The Board Remuneration Committee was established in 2012 to consider and determine all elements of the remuneration of Bank employees. The Committee is chaired by a non-executive Director, with two other non-executives Directors as members. The CBSI Legal & Compliance Officer is the Secretary to the Committee. There was no committee meeting in 2014 as a major review of terms and conditions was already undertaken in 2013.

### Board Disciplinary Appeal Committee

As its name suggests, the Board Disciplinary Appeal Committee (BDAC) is set up to hear and review appeals by staff against any disciplinary actions that the Disciplinary Committee of the Bank may recommend against a staff. There are five members to the BDAC consisting of the Governor as the Chairman, one non-executive Board Director, two chief managers appointed by the Chair, one of whom must be from the department from which the staff is the subject of disciplinary action, and a member of the Staff Association. The Legal Officer and the Chief Manager of Human Resources & Corporate Services department also attend BDAC meetings.



Ms. Nakubyana Mungomba and Mr. Kenneth Especkerman-True, two ODA officers working as Senior Research Analysts in the Economics, Research and Statistics Department, stand in front of CBSI Building. Mr. Especkerman-True ended his two year term with the CBSI on 28 August 2014 as Ms Mungomba took over from him. Photo by CBSI

departments and units work together to achieve the mission of the Bank. With the exceptions of the Internal Audit Unit which reports directly to the Board Audit Committee and the SIFIU which reports to the Anti-Money Laundering Commission (AMLC), all the departments and units report to the Governors' Office.

### Staff Compliment

At the end of 2014, the total number of staff (inclusive of

service staff) employed in the Bank was 124. The Bank has a staff establishment of 127. As at the end of the year, the composition of the Bank's human resource capital in terms of its gender balance is 60% male and 40% female. Excluding the governors, five out of eighteen management positions are filled by females. The Bank continues to scan the human resource market in Solomon Islands for qualified females to fill its technical and management positions.

In 2014, the Bank recruited three new officers for different positions within the Bank while one officer retired under the CBSI staff early retirement scheme.

### Staff Training and Development

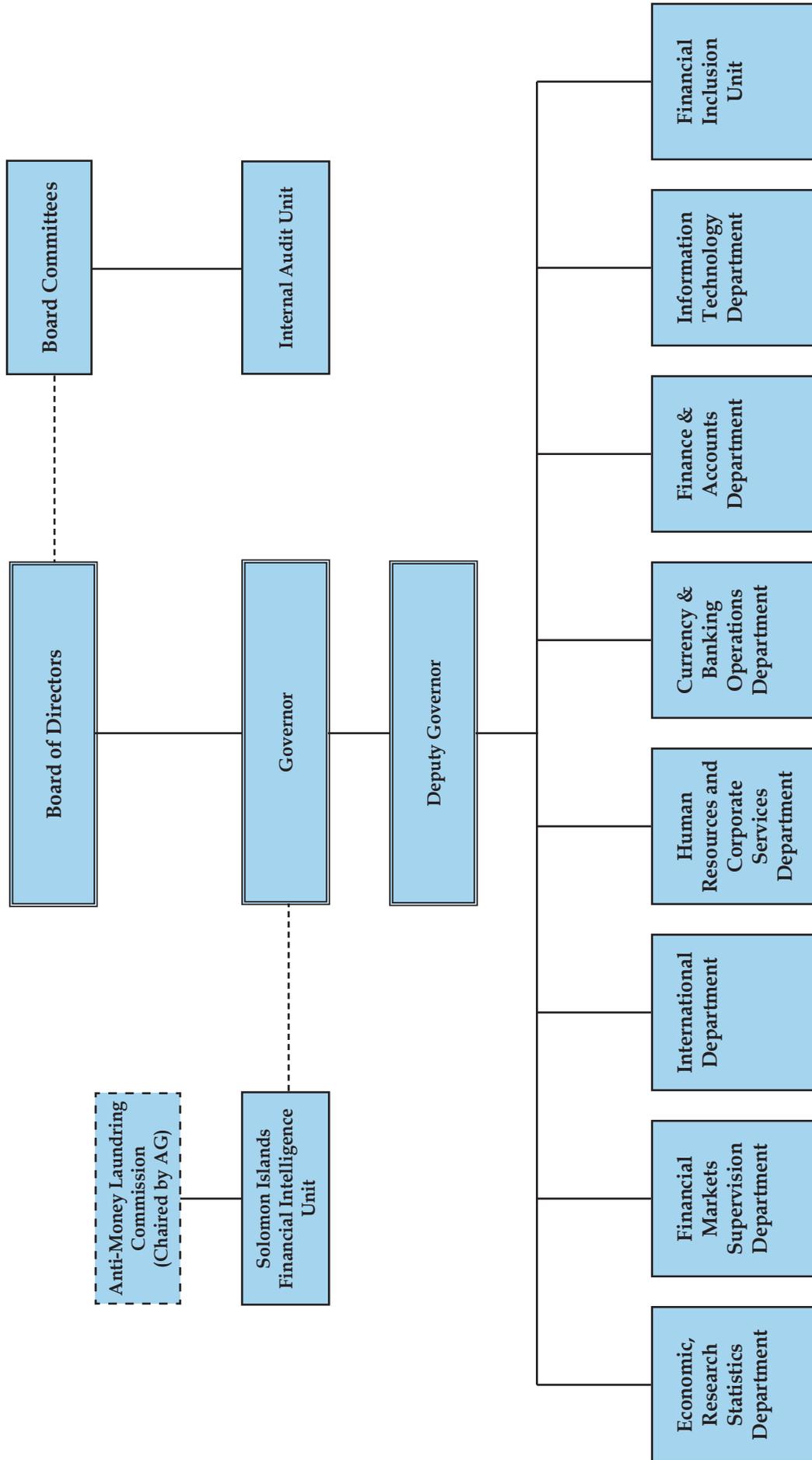
The Bank values its investment in the quality and calibre of its human capital as a critical input to enhance productivity and to position the Bank to meet its mandate. As such the Board sets aside an annual training budget towards human capacity development. Apart from its own budget, CBSI also received funding support from other bilateral partners particularly the International Monetary Fund (IMF), the Australian Prudential Regulation Authority (APRA), AusAid/DFAT, Alliance for Financial Inclusion (AFI), PFIP/UNDP; Commonwealth Secretariat, Pacific Financial Technical Assistance Centre (PFTAC) and the Asian Development Bank (ADB). These bilateral partners funded technical training for CBSI officers in monetary policy analysis, economic forecasting, banking and financial services supervision, financial inclusion and economic statistics.

The Bank also assisted staff pursue further academic qualifications through full-time and part-time training sponsorship. Around 15% of staff undertook training in 2014. Most of these were to pursue higher qualifications while others enrolled in the Distance Flexible Learning (DFL) training for up skilling in particular knowledge gaps as identified in the annual performance assessment. As at the year-end four officers graduated; two with Masters Degrees in Management & Business Administration and the other two with Bachelor of Commerce Degrees in Accounting and Banking.

### Community Relations

In 2014, the CBSI supported the victims of the "April flash floods" by donating 85% of its Donations budget to the National Disaster Management Office. As part of its annual social responsibility the Bank provided cash prizes for the secondary schools National Speech competition held each year.

# Organisational Chart as at December 2014



## CENTRAL BANK OF SOLOMON ISLANDS BOARD OF DIRECTORS



**DENTON RARAWA**

Governor and Chairman of the Board

- Governor since August 2008;
- Chairman, Solomon Airlines Ltd;
- Chairman, National Financial Inclusion Taskforce (NFIT);
- Deputy Chairman, Solomon Islands Anti-Money Laundering Commission (AMLC);
- Vice Chairman, Solomon Islands National Trade & Development Council (NTDC);
- Vice Chairman, Alliance for Financial Inclusion (AFI) Committee on AFI Independence;
- Vice Chairman, Solomon Islands Football Federation (SIFF) Telekom S-League Board;
- Director, Investment Corporation of Solomon Islands (ICSI);

Previous positions held:

- Deputy Governor, CBSI;
- Chairman, Economic Association of Solomon Islands (EASI);
- Director, Solomon Islands Plantations Ltd (SIPL);
- Director, Solomon Printers Ltd (SPL)
- Director, Foreign Investment Board (FIB)



**TELE BARTLETT**

Managing Director, Liberty Holdings

- Board Member, Women in Business Association

Previous positions held:

- Teacher, Honiara Technical Institute



**GANE SIMBE**

Deputy Governor

- Appointed Deputy Governor, 18th September, 2008
- Member, CBSI Board Audit Committee
- Current Chairman, Pacific Islands Working Group on Financial Inclusion
- Director, SolTuna Limited

Previously held position:

- Manager Financial Institutions Department; CBSI;
- Manager Exchange Control (International Department), CBSI
- Assistant Manager, Currency & Banking Operations; CBSI
- Manager Administration, Solrice Limited



**JOHN USURAMO**

Campus Director,  
USP Solomon Islands Campus

Previous positions held:

- Group Manager Student Administration Services
- Assistant Registrar, USP
- Personal Officer, SICHE



**FRED FAKARI'I**

Permanent Secretary, Ministry of Finance and Treasury

Previous positions held:

- Permanent Secretary, Ministry of Home Affairs
- Under-Secretary, Department of National Unity, Reconciliation and Peace
- Under-Secretary, Department of Public Service, Office of the Prime Minister
- Director of Public Sector Reform
- Chairman of the National Disaster Council



**SHADRACH FANEGA**

Board Member

May 2001 to October, 2014

- Former PS MOFT (Ex-Officio)
- Current PS for Ministry of Development Planning & Aid Coordination

Previous positions held:

- Chairman, Central Tender Board
- Chairman, Monthly Monetary Meeting
- Member, Solomon Islands National University Council

## CENTRAL BANK OF SOLOMON ISLANDS BOARD OF DIRECTORS



**LILLY LOMULO**

Human Resource Manager  
Solomon Tobacco Co. Ltd

- Member, CBSI Remuneration Committee



**PRIMO AFEAU**

Private Legal Practitioner

- Director, Solomon Airlines
- Trustee, Honiara Golf Club
- Chair, Committee of Prerogative of Mercy

Previous positions held:

- Attorney General of Solomon Islands
- Chairman, Anti-Money Laundering Commission
- Director, Transparency Solomon Islands



**LOYLEY NGIRA**

Chief Executive Officer, Telekom

- Member CBSI Audit Committee
- Chairman, Solomon Islands Broadcasting Corporation

Previous positions held:

- Chief Operating Officer, Telekom
- Chief Engineer, Solomon Islands Broadcasting Corporation



**KATALULU MAEPIOH**

Board Member

Manager, Eagon Pacific Plantation Ltd

- Chairman, CBSI Board Committee 2014

Previous positions held:

- Manager, Banking Supervision, CBSI
- Manager, Currency & Banking Operations, CBSI
- Manager, Adventist Book Centre



**BELLA SIMIHA**

Chief Manager, Human Resource & Corporate Services

Secretary to the Board since 2009

Central Bank of Solomon Islands  
MANAGEMENT 2014

GOVERNORS OFFICE



Denton Rarawa  
Governor



Gane Simbe  
Deputy Governor

INFORMATION & TECHNOLOGY DEPARTMENT



Edward Manedika  
Chief Manager



Marlon Houkarawa  
Manager

HUMAN RESOURCE & CORPORATE SERVICES DEPARTMENT



Bella Simiha  
Chief Manager



Rose Sulu  
Manager/ HR



John Bosco  
Manager/ CS

FINANCE & ACCOUNTING DEPARTMENT



Emmanuel Gela  
Chief Manager

NATIONAL FINANCIAL INCLUSION UNIT



Caroline Kanoko  
Manager

Central Bank of Solomon Islands  
MANAGEMENT 2014

CURRENCY & BANKING OPERATIONS DEPARTMENT



Daniel Haridi  
Chief Manager



Joe Vasuni  
Manager

ECONOMIC RESEARCH & STATISTICS DEPARTMENT



Michael Kikiolo  
Chief Manager



Elizabeth Ragimana  
Manager

FINANCIAL MARKET SUPERVISION DEPARTMENT



Raynold Moveni  
Chief Manager



Trevor Manemahaga  
Manager

INTERNATIONAL DEPARTMENT



Raynick Aquillah (Late)  
Chief Manager



Ali Homelo  
Manager

INTERNAL AUDIT UNIT



Oliver Karoa  
Manager

SOLOMON ISLANDS FINANCIAL  
INTELLIGENCE UNIT



Jimmy Sendersly  
Director

## CHAPTER 3: MONETARY POLICY DEVELOPMENTS

### Monetary Policy Formulation

The process of monetary policy formulation at the Central Bank of Solomon Islands (CBSI) involves four stages. At the first stage, the Economics, Research and Statistics Department (ERSD) is responsible for formulating monetary policy. The department reviews recent macroeconomic developments and prepares a report for the Monetary Policy Committee (MPC).

The report and recommendations are then presented to the MPC which meets one week prior to the Board Meeting. Members of the MPC include the Governor (Chairperson), Deputy Governor and senior managers of the Bank. At these meetings, extensive discussions take place on various economic indicators, as well as the latest developments in the economy and considerations for appropriate monetary policy setting. Once an agreement has been reached in the MPC, the Monetary Policy Stance (MPS) is presented to the CBSI Board for review and comments. The Board deliberates on the report and gives approval for the proposed MPS. Once the Board's comments are incorporated into the document, the MPS is conveyed to the public via press release. These press releases are also posted on the Bank's website at [www.cbsi.com.sb](http://www.cbsi.com.sb).

In 2014, five MPC meetings were held, two in the first half of the year and three in the latter half. Key issues that were deliberated on at the meetings included an update on key macroeconomic trends, the bi-annual MPS that was published in March and September, open market operations update, exchange rate policy changes and various research papers.

### Monetary Policy Stance

Over the course of 2014, CBSI altered its monetary policy stance from a neutral stance in the March Monetary Policy Statement, to an accommodative stance in September. This move was partly in response to projected developments showing that the Solomon Islands economy was perform-



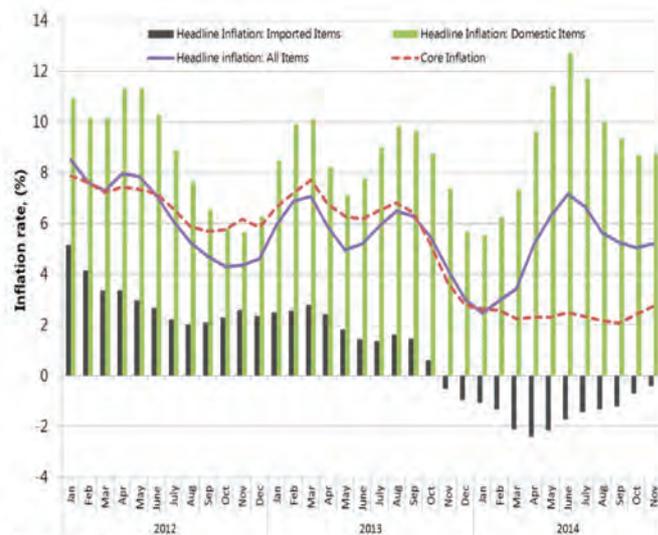
Messrs. Arto Korvanen and Chris Becker, IMF technical advisers shared a moment of analytical discussion with Governor Denton Rarawa and CBSI Management team on 22 September 2014. CBSI receives many technical assistance from IMF in conducting its work. Korvanen and Becker were assisting the CBSI to review its Exchange Rate Policy implementation. Photo by CBSI

ing below potential, leaving room on the inflationary front to accommodate further increases in aggregate demand.

Price stability remained the primary mandate of the Bank as stipulated in the CBSI Act 2012. In keeping with this, a projected inflation band of 4% to 6% was set for 2014. While the year started off with inflation below this band, the flash floods in April saw headline inflation temporarily overshoot the band to peak at 7.2% in June. This was primarily as a result of domestic supply constraints forcing up domestic inflation. Nonetheless, this pressure dissipated quickly and as the year drew to a close, inflation was well within the desired range at 4.8% in December. Meanwhile, plans to compile a national retail price index to measure inflation across the country have started bearing fruit with the project having started in November 2014.

The CBSI also reviewed policies and regulations within its means to foster investment and support private sector activities. This included reviewing of the exchange rate margins and exchange control policies. The exchange rate arrangement of pegging the local currency to a basket of currencies was maintained, while closely monitoring exchange rate developments for Solomon Islands major trading partners. Towards the end of the year, the local currency was allowed to move in tandem with the basket of trading currencies within slightly wider margins to minimise possible exchange rate misalignments.

Figure 3.1 Headline and Underlying Inflation Rates



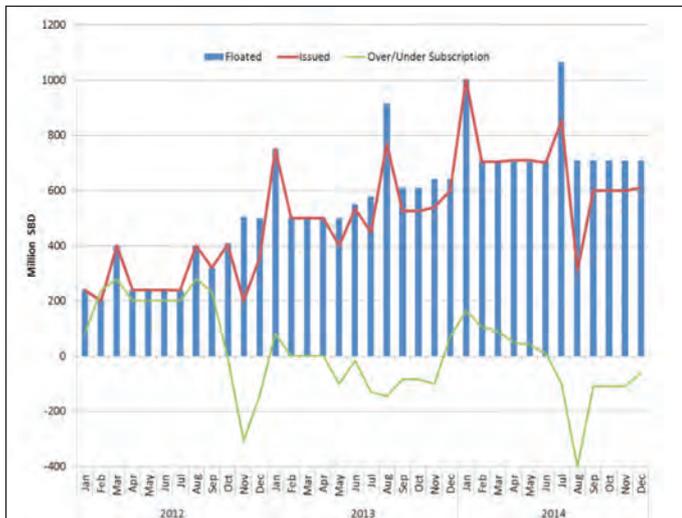
Source: CBSI and NSO

### Open Market Operations

With the level of excess liquidity remaining high in the economy, the Central Bank increased the volume of Boko Bills issued early in 2014. From mid-February, this volume was raised to \$355 million per fortnightly auction, and was maintained at this level for the rest of the year.

This, coupled with other factors<sup>3</sup>, saw the level of excess liquidity fall by \$141 million year-on-year to \$824 million in December. This was achieved despite persistent under subscriptions throughout the second half of the year. The weighted average interest rate for Bokolo Bills remained relatively unchanged throughout 2014 at 0.61%, up by 2 basis points from December levels the year before.

Figure 3.2: Bokolo Bills Market



Source: CBSI

The draining of excess liquidity was further supported by the Solomon Islands Government Treasury Bills, with the cap being maintained at \$40 million. This market continued to be oversubscribed throughout 2014 with monthly public bids averaging \$19 million compared to the average floated monthly auctioned volume of \$10 million<sup>4</sup>. This oversubscription points to the public’s continued desire for more investment opportunities. Over the second and third quarters of 2014, the weighted average interest rate exhibited a downward trend down to 0.34% in September, before recovering in the final quarter to end at 0.48% in December.

<sup>3</sup> These include large overseas payments, increased private sector lending, and the halt of gold export receipts.

<sup>4</sup> The volume floated represents the matured T-bills for that period which when reissued maintains the total stock at \$40 million.



Tourists viewing the carvings and crafts being displayed at the foreshore of Gizo Hotel, Western Province on 15 January 2015. In 2014 the total number of tourist’s arrival by air was 20,070 and those arriving by cruise boat 2,787. Average length of stay by a visitor was 16 days. Photo by Gane Simbe

Despite free liquidity being excessively high throughout 2014, it was anticipated that this would not pose inflationary pressures. While private sector credit continued to grow, it did so at a slow but steady pace. Furthermore,



Fishermen sell fresh fish at Gizo market. Sale of fish in markets like Gizo and Honiara is one of the key sources of income for rural fishermen. Photo by Gane Simbe

most of these excess funds were held in commercial bank call accounts with CBSI. The cash reserve requirement (CRR) was maintained at 7.5% of total deposit liabilities which saw CRR holdings with CBSI increase by 9% year-on-year to \$239 million, corresponding with an increase in deposit liabilities.

## CHAPTER 4: CENTRAL BANKING OPERATIONS

### Public Communication and Information Dissemination

The Bank as part of its public disclosure to its stakeholders on the conduct and effect of its monetary policy used the print, radio and internet channels to disseminate information. It published its assessments and commentaries of the Solomon Islands economy in its monthly economic bulletins, quarterly reviews, bi-annual monetary policy statements and the annual report to inform the public about the Bank's operations and audited financial accounts.

Besides the economic publications, the CBSI also publishes financial literacy pamphlets and Money Smart Day magazine aimed at educating the people about the financial services in the country. To reach out to the whole country, the Bank produces a weekly radio program *Money Matters* that is broadcasted over the Solomon Islands Broadcasting Corporation.

The publications are also posted on the CBSI website to enable those who want to know about the Solomon Islands economy both in the country and abroad to get the information they want. Central Bank officers also made presentations to various forums organised by different stakeholders including government agencies, private sector companies, donor agencies and schools on developments in the SI economy.

### Research

As part of a series of econometrics training provided by Professor Paresh Narayan from Deakin University in Australia, the Bank published two empirical research papers on the CBSI website in 2014. These papers are aimed at stimulating debate on financial and economic issues in the economy. The first paper was titled "*Estimating the Money Demand functions of Solomon Islands*" and the second was "*Understanding the Monetary Policy Transmission Mechanism in the Solomon Islands*". The Asian Development Bank supported the engagement of technical assistance to assist the Bank.

|                            | Numbers published, distributed and broadcasted |
|----------------------------|--|
| Monthly Economic Bulletin  | 768  |
| Quarterly Review           | 600  |
| CBSI Annual Report         | 200  |
| Money Smart Day            | 3000   |
| Money Matters Program      | 29   |
| Press Releases             | 19   |
| Featured Articles in Media | 17   |
| Research Papers Published  | 2  |

Source: CBSI

### Macroeconomic Statistics

CBSI worked in collaboration with international and local agencies such as the International Monetary Fund (IMF), Pacific Financial Technical Assistance Centre, Australian Bureau of Statistics and Solomon Islands National Statistics Office to improve data quality and timely dissemination and publication of macroeconomic statistics. As part of this objective, Bank officers were given specialised statistical trainings from three visiting technical assistance missions. These trainings were focused on the external sector statistics (ESS) project and macroeconomic forecasting. Staff also attended short technical courses overseas relating to Debt Management Statistics, Government Finance Statistics (GFS) and National Accounts.

Following the completion of the GFS project during the year, the Bank finally migrated and aligned its fiscal accounts statistics and quarterly reviews to the required standards in the 2001 GFS manual. In December, the Bank sent some of the fiscal statistics, particularly on the Central Government statistics for publication in the IMF Fiscal Year Book. On the ESS project, the Bank was able to complete the Balance of payments Manual 6 Standards classifications with data sent to the IMF. A mission for the Monetary and Financial Statistics (MFS) project to improve MFS data coverage is expected in April 2015.

### Exchange Rate Policy reviewed

One of the core functions of the Bank as outlined in section 9(b) and Section 16 of the CBSI Act 2012 is "to contribute to determining the exchange rate regime after consultation with the Government and determine and implement the exchange policy". During the year, the Bank reviewed the exchange rate policy with the support of IMF technical assistance. The objective was to make the administration of the exchange rate more flexible. However, the policy to peg the Solomon Islands dollar value to an invoice-weighted basket of currencies was kept unchanged.

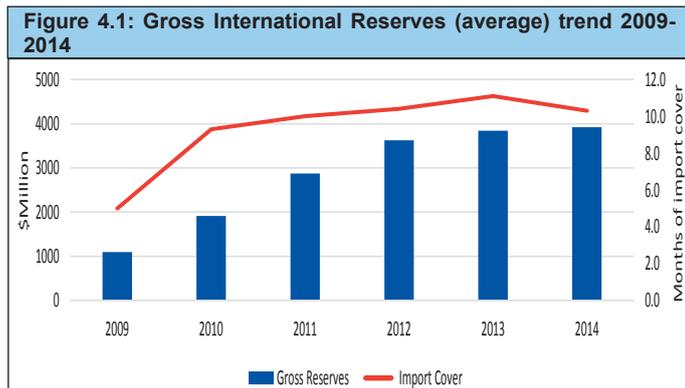
The basket of currencies consisted of the Australian dollar; British Pound Sterling, Japanese Yen, New Zealand dollar and the United State dollar. A policy decision was made to remove the bands that were used to manage the daily movement of the Solomon Islands dollar against the US dollar. This allowed the Solomon Islands dollar more flexibility against the Basket. After the implementation of the exchange rate review, the SBD gradually depreciated against USD to \$7.63 as at end of December 2014 from \$7.36 at the start of the year.

### Management and investment of international reserves prioritized safety and liquidity in a challenging international market

Management of the international reserves is one of the functions of the Bank specified under Sections 9(d), 9(e) and 17 of the CBSI Act 2012. The provision requires that

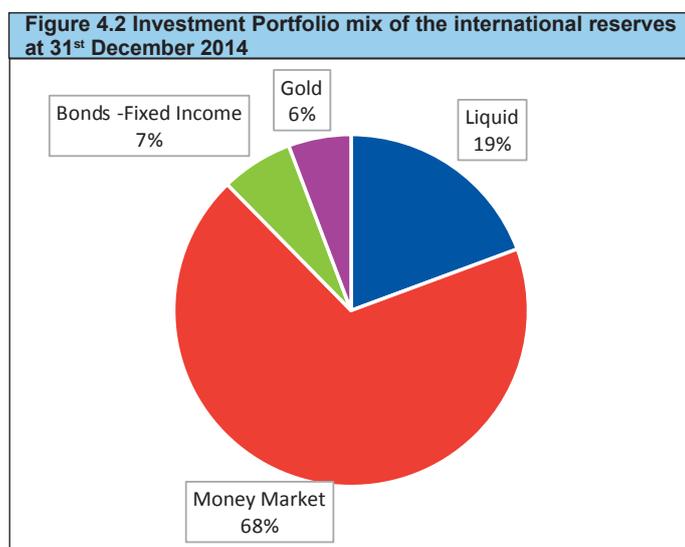
“the Central Bank shall conduct transactions in international reserves and manage such reserves consistent with international best practices and subject to its primary objectives to achieve and maintain domestic price stability, respecting the safety, liquidity and yield in the order of priority”.

Whilst on average international reserves level was buoyed around USD 551.0 million, 2014 was a challenging year particularly for yield and returns for investments of financial assets. The average annualised yield rate for the year dropped to 1.17% from 1.18% in the previous year.



Source: CBSI

The international money markets remained subdued and interest income low driven by the accommodative monetary policy stances taken by the central banks in advanced economies around the world. Under this international market scenario; the Banks’ investment portfolio mix was placed in money market instruments with maturities between 1 to 12 months. The portion of the reserves required to meet the international trading needs of the economy was held in call account balances with other central banks. Part of the reserves was invested in gold and bonds (see pie chart below). No further investment was made in bonds and gold during year.



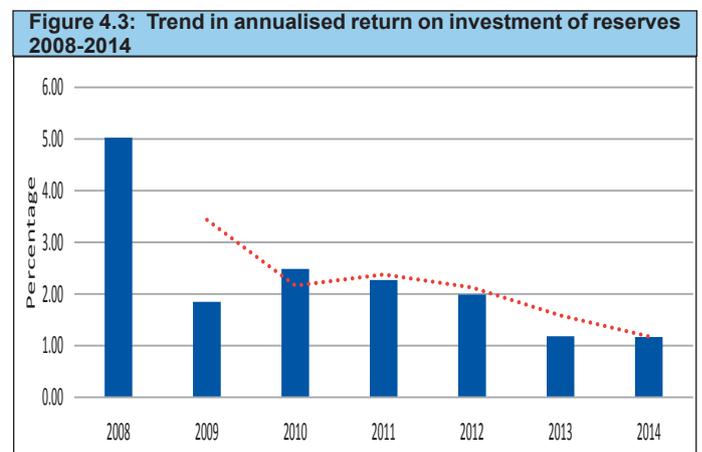
Source: CBSI

In terms of reporting and monitoring of compliance with the Board’s approved investment portfolio mix, the international department reports to the Investment Advisory Committee (IAC) on a quarterly basis. The Internal Audit Unit and the Middle Office of the International Department also carry out independent risk assessments of the investment activities and reports presented to the Board Audit Committee or to IAC.

**Interest Income earned from investment of international reserves lower than the previous year**

The global financial market remained fragile during the year resulting in interest rates for deposits in major currencies falling or remained static at low levels during 2014 because of the accommodative monetary policy stances of advanced economies. As a consequence, investments options were limited and the Central Bank priority focus was on ensuring the safety and maintenance of the liquidity of the international reserves.

Total interest earned from foreign reserves investments in 2014 amounted to \$46.48 million; this was 1.08% higher than that of 2013, underpinned mainly by continuous low market interest rates available with the reputable financial institutions in the market and adjustment of Bond income in December 2014. Average annualised return on investments as at the end of December 2014 declined slightly to 1.17% from 1.18% in 2013.



Source: CBSI

The appreciation of the Solomon Islands dollar against some of the basket currencies resulted in a net foreign exchange loss of \$28.9 million. The Bank also made a small exchange rate revaluation gain on gold holdings by the end of the year as well.

**Back Office Operations**

In terms of SWIFT operations, total messages received and sent increased during the year as shown in the Table 4.2.

**Table 4.2: Number and Value of SWIFT transactions in 2014**

|                                     | 2013 | 2014 |
|-------------------------------------|------|------|
| Outgoing messages (Received)        | 953  | 1039 |
| Incoming Messages (sent)            | 1589 | 2279 |
| Value of Receipts transacted (\$M)  | 549  | 581  |
| Value of Payments transferred (\$M) | 248  | 204  |

Source: CBSI

### Exchange Control Administration.

One of the functions of the Bank is to regulate the international exchange of money as specified in the CBSI Act 2012 and the Exchange Control Act. In this regard CBSI administers the Exchange Control Act and regulations on behalf of the Government.

The Exchange Control Act empowers the Bank to make regulations, to confer powers, and impose duties and restrictions in relation to foreign exchange, foreign exchange resources, protection of currency or public credit or revenue and for matters connected therewith and incidental thereto. The primary goal for exchange control is to ensure that the country benefits from its resources and all goods and services exported.

Commercial banks are appointed authorised dealers under exchange control and can process and facilitate trade transactions as per the specific requirements of the exchange control policy and regulation. The commercial banks continued to facilitate international transactions as authorised dealers. There are four commercial banks in the country that are appointed as authorised dealers; ANZ Bank, Westpac Bank, Bank South Pacific and Pan Oceanic Bank.

### Applications for Temporary Resident (TR) Status

The number of non-residents given approvals for Temporary Residential (TR) status increased in 2014 relative to the previous year (see Table 4.2). Under the Exchange Control regulation TR can be granted to temporary residents, where the person is a non-resident and intends to reside in Solomon Islands for a period of four years or less. Non-residents who resided in the Solomon Islands for over four years but who can produce evidence of firm intention to resume permanent residence overseas within the next few years can apply for TR under the exchange control regulation. Non-residents with TR status are permitted to remit funds/make payments abroad while residing temporarily in the country.

**Table 4.3: Number of temporary residents status approved during the year**

|                   | 2013 | 2014 |
|-------------------|------|------|
| New applicants    | 101  | 105  |
| Renewals          | 85   | 127  |
| Total TR Approved | 186  | 232  |

Source: CBSI

### Number of companies applying for and granted permission to hold Foreign Currency Accounts (FCA) increased in 2014

As shown in Table 4.3 all new applications seeking exchange control approval to open foreign currency accounts both locally and offshore were non-exporters. A total of \$934 million equivalents of foreign currencies was transacted and held within the foreign currency accounts approved holders in 2014. These amounts were held in US dollars; Australian dollars; Euro; NZ dollars; Japanese Yen and PNG Kina.

**Table 4.4: Number of approved foreign currency accounts held by exporters and non-exporters, 2013-2014**

|                           | 2013 | 2014 |
|---------------------------|------|------|
| Account holders           | 23   | 38   |
| Qualified Exporters       | 10   | 10   |
| Non-Exporters             | 13   | 28   |
| Total accounts held       | 55   | 63   |
| On-shore                  | 46   | 57   |
| Off-shore                 | 9    | 6    |
| Total value: (\$ million) | 896  | 934  |

Source: CBSI

### Foreign Exchange (FX) Restricted Classified Dealers

The number of outlets licensed to operate as restricted classified foreign exchange dealers increased in 2014. These license holders are permitted to provide money changer and money transfer services in the country.

**Table 4.5: Number of approved Foreign Exchange Money Changer License 2011-2014**

|                             | 2011 | 2012 | 2013 | 2014 |
|-----------------------------|------|------|------|------|
| Money Transfer services*    | 3    | 4    | 5    | 4    |
| Money Changer Services      | 5    | 6    | 9    | 11   |
| Total FX Classified Dealers | 8    | 10   | 14   | 15   |

\*As Western Union and Money Gram Agency and Sub-agents

Source: CBSI

In 2014, three new applications for foreign exchange classified dealers licenses were approved and issued. Of these three, one new application was for foreign exchange money transfer services agent for money express international and the other two licenses were issued to two local resident entities. The Bank also assessed and approved 12 new sub agents for money transfer dealers; 7 within Honiara; 2 in Western province; 1 in Choiseul province and 2 in Malaita province. One classified money transfer license holder was cancelled during the year following request by the dealer. These sub agents report directly to an authorised classified foreign exchange license holder for our reporting and compliance purposes.

### Private Sector Debt (Private Sector Offshore Borrowing)

External Offshore borrowing by private resident compa-

nies or individuals (including a company incorporated in Solomon Islands and the Solomon Islands branch of an overseas incorporated company or firm) must first seek exchange control approval from the Bank prior to entering into an external loan agreement with any external institutions or any external lender. This is an exchange control requirement under the exchange control regulation. This includes intercompany soft loans or borrowing by existing resident companies or new investment establishments by companies incorporated in Solomon Islands. Without the prior exchange control approval, future repayments or remittances of loans and advances will not be considered for approval.

**Table 4.6: Number of Private Overseas Borrowings Approved under Exchange Control Requirement: 2012-2014**

|                        | 2012  | 2013  | 2014  |
|------------------------|-------|-------|-------|
| Applications received  | 6     | 12    | 14    |
| Value in SBD (million) | 997.2 | 106.8 | 327.0 |

Source: CBSI

A total of fourteen (14) offshore borrowing applications were received during the year and all have met the exchange control prudential level and conditions and were approved. The private sector offshore loans were all contracted to resident corporate entities totalling \$327 million; comprising of USD 43.0 million, AUD 0.320 million and NZD 0.120 million.

### Exports Administration

One of the primary goals of exchange control is to ensure that the country fully benefits from its resources and all goods and services it exported. It is therefore required under exchange control policy and regulations that all amounts of exports proceed must be remitted back to Solomon Islands within 3 months from the date of exports. There are two Export frameworks under which exports are administered and monitored by CBSI. These are the General Authority to Export and the Specific Authority to Export.

The General Authority to export permit covers all goods and services with the exception of round logs. It does not require exchange control approval but closely monitors details of export proceeds for recording and reconciliation purposes. However, a Specific Authority to export permit may be required on certain goods by other authorities before shipments of consignments can be released by Customs & Excise Division.

'Specific Authority to exports policy' on the other hand governs and administers the process of exporting round logs in the country. This means that exports of round logs must be granted 'Specific Authority' permit from CBSI before logs can be shipped out of the country.

### Exports: - Administration of Specific Authority.

In terms of foreign exchange export applications for round log exports under 'Specific Authority to Export', a total

of 848 applications were received during 2014. This was equivalent to 2.449 million cubic metres of round logs and valued at approximately \$2,205 million, a year-on-year increase of 14.9% from the log export value in 2013.

**Table 4.7: Number and Value of Applications for Specific Authority to Export 2012-2014**

|   | 2012  | 2013  | 2014  |
|---|-------|-------|-------|
| Total Applications approved                     | 866   | 846   | 848   |
| Total Value of Exports-SA Approved (\$ Million) | 1,750 | 1,876 | 2,205 |
| Volume of Exports - SA Approved (Million m3)    | 2.096 | 2.269 | 2.449 |
| Average value per application (\$ Million)      | 2.02  | 2.22  | 2.60  |
| Average value per M3 (\$)                       | 835   | 827   | 900   |

Source: CBSI

### Imports payment administration: Applications above required CBSI limits.

In-terms of exchange control payment limits issued by CBSI to banks, CBSI maintained its payment limits during 2014. All applications for travel, personal transfers and sustenance payments above \$30,000 need to seek CBSI approval prior to facilitating the transaction with the commercial banks and for trade and services payments, amounts exceeding \$100,000 also need to seek CBSI approval prior to facilitating payments with the commercial banks. Foreign exchange payments for amounts less than the two thresholds i.e. \$100,000 and \$30,000 can be assessed and facilitated by the authorised dealers (commercial banks) without CBSI approval.

For all Capital and financial accounts payments exchange control approval is still required from CBSI to facilitate such payments. Some examples of capital and financial transactions are dividends, loan repayments, equity proceeds, and property proceeds.

**Table 4.8: Number and Value of Foreign Exchange applications approved by CBSI: 2011-2014**

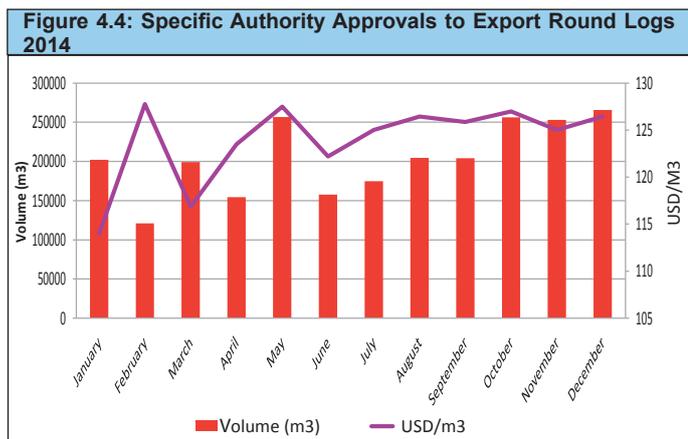
|   | 2011  | 2012  | 2013  | 2014  |
|---|-------|-------|-------|-------|
| Number of applications approved             | 5922  | 6898  | 6439  | 7503  |
| Value of applications approved (\$ Million) | 3,281 | 4,754 | 5,044 | 6,228 |
| Average Value per application (\$ Million)  | 0.544 | 0.689 | 0.783 | 0.830 |

Source: CBSI

During 2014 a total of 7503 payments and remittances applications valued at approximately \$6,228 million (\$5,432 million in 2013) (for trade and services, financial & capital payments travel and personal remittances) were channelled through CBSI International department exchange control office for assessment and approval. Of the total applications received, 199 applications did not meet exchange control conditions and were declined. On average 144 applications valued at approximately \$119.0 million per week were assessed in 2014.

A total of 3988 applications for goods on credit valued at \$1,746.85 million were processed in 2014 and travel appli-

cations valued at \$15.2 million were also approved during the year.



Source: CBSI

The average log export price for 2014 stood at USD118.00 per cubic metre. This was due to a drop in the world market prices for round logs during the year compared to the previous year's prices. The highest log export price was USD130.00 per cubic metre that was recorded in November 2014.

### Compliance and Reconciliation of Exports

Regulation 13 of the exchange control regulations requires that full proceeds of goods exported are promptly received in Solomon Islands in an approved manner:

- Payment for goods exported is received within three months before and after the date of export.
- The export price is not less than the price which might be reasonably expected in the open market conditions.
- The foreign currency proceeds are promptly sold to or credited with a bank in Solomon Islands.

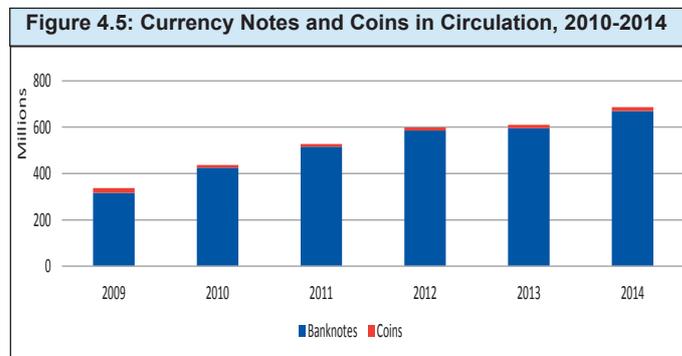
The Central Bank continues to strengthen its exchange control monitoring and compliances of all exports under general authority during 2014.

### Currency Administration and Management

Section 9(f) of the Central Bank Act 2012 provides that one of the functions of the Bank is 'to issue, regulate and manage the currency of Solomon Islands'. Some of the specific responsibilities required of this function includes; currency stock management; issuing of notes to commercial banks for circulation; receiving of currency deposits from commercial banks and Solomon Islands government; sorting and destruction of old and soiled notes; designing and ordering of new notes or coins; advising and educating the public on care for notes and coins; and warning public about counterfeit notes. Outlined below are the activities performed by the Bank to implement this function.

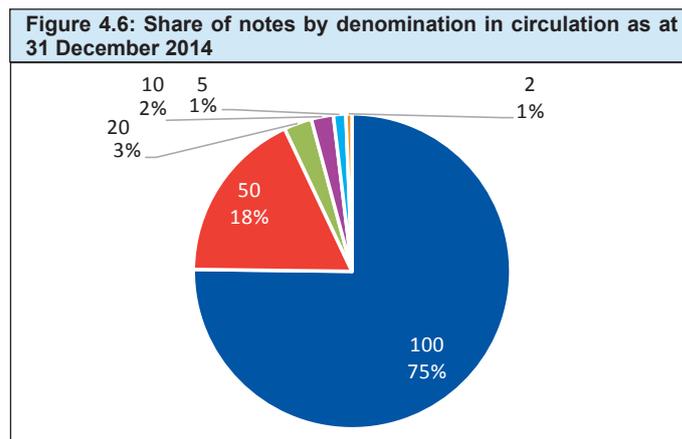
### Currency in Circulation Stock

As at the end of 2014, the total value of currency notes and coins in circulation increased by 12.6% to \$687 million from \$610 million in the previous year. Currency notes accounted for \$669 million of the total circulation and coins made up about \$18 million. Chart 4.5 below shows the trend in the currency in circulation from 2010 to 2014.



Source: CBSI

The pie chart below shows the share of each note in terms of volume (number of notes) denomination in circulation at the end of the year.



Source: CBSI

The 100 dollar note represented 75% of the notes in the hands of the public; reflecting its popularity as the note for payments and store of value. Coins in circulation increased by 28% in 2014 compared to 2013. Of the total coins, 49% was in \$2, 29% was \$1, 15% was in 50 cents and the balance shared by 20 cents and 10 cents.

### CBSI approved enhanced design \$100 banknote with the latest security feature and to be released into circulation in 2015

The Bank has approved improvements to the design and features of the \$100 note in June 2014, incorporating the latest security features to prevent counterfeiting of the note. The new \$100 note will be available for circulation in early 2015. Like the new \$50 note, the most prominent security feature is the Optiks™ super wide security thread with a transparent window, in which images of the shark

and crocodile from the country's Coat of Arms can be clearly seen. The main design motifs in the \$100 portrays rural livelihood, social and economic activities in rural Solomon Islands.

**Counterfeit Notes were still in circulation**

The Bank confiscated from circulation a total of 32 pieces of counterfeit notes in 2014 compared to 16 pieces in 2013. Of the total counterfeit notes impounded, 29 pieces were counterfeits of the \$100 note and 3 pieces of the \$50 note of which 2 pieces were counterfeits of the recently introduced \$50.

The Bank recognized that educating people to develop the habit of checking the security features of genuine currency notes is one of the ways it can help people not fall victims to those circulating the counterfeit notes. To educate the public about the risks of circulating counterfeit notes the Bank had used the radio and print media throughout the year. The people were encouraged to develop the habit to properly check currency notes before accepting them in exchange for goods or services.



Governor Denton Rarawa signs the new design for the 100 dollar currency note. The new \$100 note was launched for circulation in April 2015. Photo by CBSI

**Numismatic items sales improved**

Total sales in 2014 amounted to \$1.4 million as compared to only \$0.7 million in 2013. This was an increase of more than 80% in sales of numismatic items which was largely attributed to sales of numismatic items offshore. CBSI participation in commemorative coin programs increased by 16 major themes that included: "Seven-In-One", World War One centenary coin, Famous Cities and Landmarks with laurels, Museum Collection series, Giuseppe Vardi and Egyptian Sphinx and Giza coins for potential income in future.

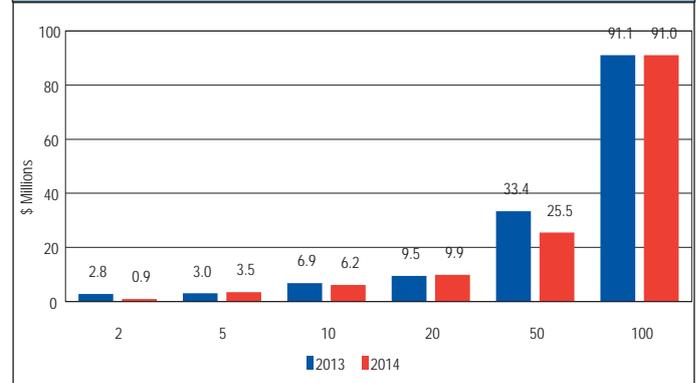
**Note Processing**

In 2014, \$148.8 million value of soiled notes was processed. A total of \$3.8 million was sorted as fit notes and returned for circulation. Of the remaining, \$137 million worth of

notes were destroyed during the year and \$5 million carried forward for destruction in 2015.

The CBSI is concerned at the high rate at which notes are returned from circulation. It generally shows poor handling of currency notes despite increased public awareness on how to care for the currency notes.

**Figure 4.7: Value of notes destroyed by denomination in 2013 to 2014**



Source: CBSI

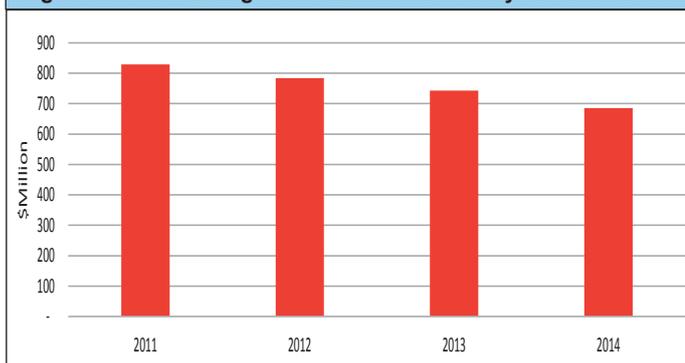
De La Rue Cash Systems Engineers conducted a Level II advanced training on the Cobra Note Sorter/ Shredder machine at CBSI. The training was attended by Central Bank staff and an engineer from Bank of Papua New Guinea. The Bank continues to invest on training of its engineers to improve efficiency and build local capacity in the Bank's back office cash operations.

**Bank continues to assist Government in the administration of the Government Debt Statistical Database**

The CBSI Debt Unit (CDU) continued to act as the secondary site for Government's external public debt database. Public debt data is kept in the CS-DRMS system while a portfolio analysis tool is maintained by the Government Debt Management Unit (DMU) for analysis of multicurrency loans. As part of its activities, CDU performed monthly loan validations on the CS-DRMS, dispatched QEDs to the World Bank and uploaded auction treasury bills results on the CS-SAS after each weekly auction. CDU also maintained the External Private Debt database. CDU also held regular meetings with the DMU on administrative and technical issues including capacity development issues.

The external public debt profile is made up of thirty (30) active loans all of which were fully disbursed. The Principal creditors include the Asian Development Bank (ADB), International Development Association (IDA), European Union (EU), International Corporation Development Fund (ICDF); International Fund for Agriculture Development (IFAD), Export Import Bank of Republic of China (EXIM) and Kuwait Fund for Arab Economic Development (KFAED).

**Figure 4.8 Outstanding Public External Debt for years 2011-2014.**



Source: CBSI

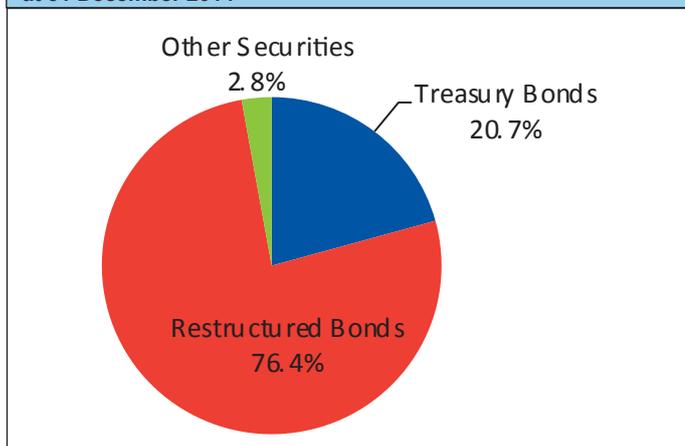
The Public Disbursed Outstanding debt (DOD) of the Solomon Islands at 31<sup>st</sup> December 2014 totalled \$685.4 million and is expected to decrease to \$644.1 million at the end of 2015. Compared to 2013, the DOD was reduced by \$57.9 million from \$743.3 million. The decrease in the total stock was mainly due to exchange rate movement and repayment of external loans during the year. Total external debt repayments in 2014 were \$58.8 million, of which \$48.7 million was for principal repayments and \$10.1 million for interest payments.

In terms of currency composition of the total official debt, the Special Drawing Rights (SDR) accounted for 83.4% of the total DOD or \$689.8 million followed by the United States dollar with 13.8% or \$113.7 million, European Currency Units with 2.8% or \$23.2 million and the Kuwait Dinar with 0.3 percent or \$3.3 million.

### Government’s Domestic Securities Debts

Solomon Islands Government (SIG) domestic debt outstanding at the end of the year was \$173.6 million, a reduction of \$31.6 million compared to \$205.3 million in December 2013. The domestic debt outstanding balance comprised of \$35.9 million in Treasury Bills, \$132.9 million in Restructuring Bonds and \$4.9 million in other SIG special securities. Debt repayment during the year totalled \$37.9 million, of which \$30.3 million was for principal and

**Figure 4.9: Composition of Government Domestic borrowing as at 31 December 2014**



Source: CBSI

\$7.6 million was for interest payments.

The major holders of domestic securities were the CBSI with 39.7%, Solomon Islands National Provident Fund (SINPF) with 31.4%, Commercial Banks with 25.1%, General Public with 1.8% and other Creditors with 2.0%. The composition of the Government domestic debt is shown in Figure 4.9.

The decline in the outstanding balances for both the external public debt and domestic debt reflected the governments continued commitment towards its debt service obligations.

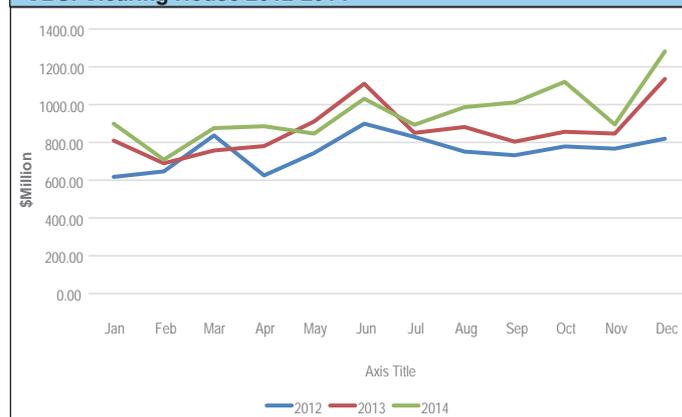
### Banking Services

The Bank continued to deliver banking services to licensed financial institutions, the Solomon Islands Government and other non-banking financial institutions as mandated in the CBSI Act 2012. Such banking services include, but are not limited to, administering SBD and foreign currency denominated accounts established with the Bank by SIG and its donor partners, facilitating payments, providing account balances, daily monitoring of free liquidity of the commercial banks and the proper upkeep of records for audit requirements.

### Clearing House Activities

The CBSI facilitated clearing of cheques drawn on the four licensed commercial banks operating in Honiara. In 2014, a monthly average of 22,098 cheques with a total average value of \$953 million passed through the Clearing House. On average, this was 9.5% higher than the monthly average value quoted in 2013.

**Figure 4.10: Trend in the Value of cheques cleared each month at CBSI Clearing House 2012-2014**



Source: CBSI

### Work to set up of a National Payments System has started

As part of its financial deepening and payment services reform agenda, CBSI recognised the need for an efficient national payments system that can cater for both high value and retail payments; using the electronic platform. Under Sections 26 and 27 of the CBSI Act 2012, the Cen-

tral Bank is given the power to provide facilities, including intra-day credit, to payment, clearing and securities settlement systems, and their participants, to ensure the safety, soundness and efficiency of the system.

Safety of the payment system is critical to the development of Solomon Islands and to assist the Bank, a Memorandum of Understanding (MOU) was entered into with the International Financial Corporation (IFC) to progress the National Payment System Reform Project with the objective of establishing a national payment system in Solomon Islands.

The main aspects of the project amongst other important functions included the development of a national payments system vision, a national payments system development plan, a national payments system act, guidelines for the legal draftsman and stakeholder communication program. CBSI continued to work closely with World Bank and IFC payment experts to prepare the documentations required for the enactment of the payment legislation. The project however still has a long way to go before completion.

### Small Business Finance Scheme

As required under the signed MOU with the Government in 2007, CBSI administered the Small Business Finance Scheme and reported to Solomon Islands Government on a quarterly and annual basis the state of the Scheme.

In 2014 five (5) loans were approved for guarantee under the Scheme against four (4) nominated in 2013. With the approved loans, the number of loans nominated under the scheme since it started was 63 loans.

At the end of 2014, total gross value of loans guaranteed increased by only \$0.655 million, which was an increase of more than 100% of the total gross value of loans nominated and approved in 2013. In aggregate, total claims paid to banks equalled \$0.904 million while \$0.781 million in guarantees had been cancelled as the loans have been fully serviced.

### Information Technology

The Information Technology Department supports the mission of the Banks through providing IT services for departments, its customers and other external clients to enable them to conduct their work effectively. This involved carrying out the following key tasks:

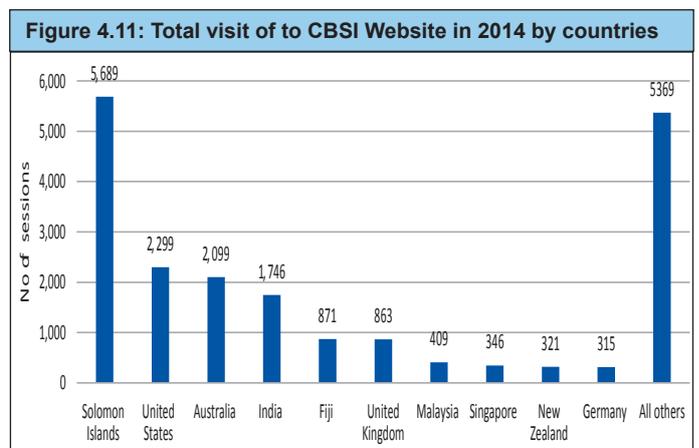
- Provided appropriate network infrastructure for the production and backup environments, the platforms for hosting and administering the CBSI IT Systems and data.
- Provided and supported IT systems development and maintenance to accommodate changes in the technology and meet the needs of the Bank.

- Provided support in availing, installing/setting up, and maintaining the needed IT hardware items such as laptops, desktops, printers/photo copier and scanners.
- Provided security of the bank’s IT resources including systems and data stored from intruders within and outside of the Bank.
- Supported the development and maintenance of the CBSI website.
- Established and maintained Internet services for the Bank.
- Provided administrative support in terms of planning, budgeting and reporting of Information Technology related areas.

During the year, the Bank carried out needed improvement and strengthening of its information system. The tasks involved improving the Local Area Network (LAN) infrastructure; installation of wireless network infrastructure to enhance network access, storage and security.

The Bank also carried out upgraded work on the Financial Sector Information System (FSIS), database software from version 5.0 to version 5.3 both on the production and the test environments; rebuilt the Bank’s Smoothwall firewall with an upgraded version to enhance the Banks web content filtering system.

To meet the internet usage by its departments, the Bank subscribed to Business package for its internet access. The Department provided ongoing support and maintenance to email, database, and computer hardware and regular updating of information on the Bank’s website with new information for the public, who regularly visit the CBSI website and gather useful information about the Solomon Islands economy. In 2014, the Bank recorded a total of 20,237 visits on the CBSI website from 187 countries (see chart below).



Source: CBSI

### IT Development Projects Progress Updates

In 2014 the Bank completed the upgrade work on its serv-

ers hosting at the production site. The upgrade work involved installation of the preloaded Windows Server 2012 (MS win server Datacenter r2 2012), created volumes, network settings and join to the domain; setup virtual machines for different systems and data migration from the old servers before decommissioning the old servers. The new servers enabled the Bank to host more virtual machines and large volume of data.

A review of the Bank's draft Information Technology Disaster Recovery Plan document was conducted and presented for further refinements. This sub Business Continuity Plan (BCP) document formed part of the Bank's BCP which identified threats to the IT systems both internal and external and set out plans to mitigate the risks and ensure business continuity.

Work on the incomplete features of the Working store system for currency stock management and reporting continued in 2014. This included design and implementation of the SIG revenue component, designed the running balances reports for the currency in circulation, conducted system tests and provided users training. This in-house developed system will reduce the manual work, involved in maintaining records of currency movements. When completed, the system would enable the Bank to keep track of its currency in circulation numbers, and important information for its monetary policy decision.

During the year, the Bank provided support to TechnologyOne in implementing the project activities on the new financial and accounting system. TechnologyOne, a foreign company won the contract for supplying and installing the Bank's new financial and accounting system. Work on the financial system involved installation of the software; setup financial system as production, training and test environment on the servers; design and setup the chart of accounts; conducted tests and training for key users on the modules available on the financial system; adjusted stationeries (cheque and service order forms) and worked on the interfaces. Work on this development project will continue into 2015 and expected to complete before mid-year 2015.

Another in-house software development progress during the year was the Exchange Control System. The system if completed would enhance the Bank's recording, accessing, monitoring and complying with foreign exchange controls on imports and exports transactions.

### Internal Audit Unit Activities

The Internal Audit Unit was able to do follow up on matters raised with the Management in previous audits. More resources were concentrated on high risk areas. The Unit was also able to arrange 4 Board Audit Committee meetings out of the 4 scheduled meetings for the year.

The Internal Audit Unit conducted and submitted its report to the Board Audit Committee and Management on the following reviews;

| Area of Review                                      | Objective of the Review   |
|---|---|
| Currency & Banking Operations                       | Accuracy & completeness in the reporting of SIG & Commercial Banks' deposits, Currency in circulation and Currency in stock                               |
| Property, Plant & Equipment (PPE)                   | Proper & complete authorisation and recording of the Bank's Assets – from acquisition to disposal   |
| Follow-up reviews of 2013 Audit Issues              | To ensure that the 2013 and other previous Internal & External Audit recommendations were implemented or appropriately responded to by Management         |
| Special Review of the Treasury Bills Tender process | The existence of Professional autonomy between the Administrators and Investors of the instrument   |
| IMF weekly/monthly Monetary Reports                 | To ensure that data sources of weekly/monthly monetary reports sent to the IMF are genuine and independently verified for their accuracy and completeness |

### IMF Safeguard Assessment

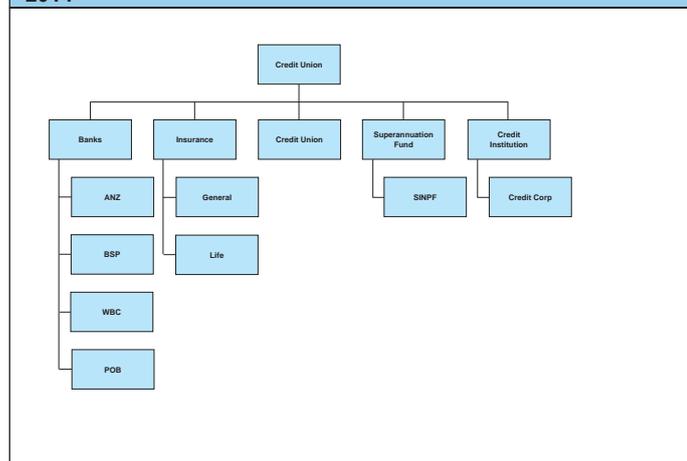
In 2014 the Internal Audit Unit compiled quarterly IMF Safeguard Assessment reports. These reports consist of high risk and more vulnerable areas and importantly how the Bank is implementing the recommendations by the IMF Assessment team.

## CHAPTER 5: FINANCIAL STABILITY

A stable financial system is critical for a small open economy like Solomon Islands. When there is stability, the system will sustain the provision of critical services like facilitating payments, extending credit and providing insurance against risk even when the system is hit by unanticipated shocks.

In 2014, Solomon Islands financial system was able to provide these critical services. Banks in particular have ample liquidity and were able to supply financial resources to households and entrepreneurs for transactional purposes and furthermore were able to meet all their financial commitments when they fall due. During the year banks maintained an average liquidity buffer of 41% of their total deposit liabilities in a quarter as against the required minimum of 7.5% and an average liquid asset to total liability coverage ratio of 67.6% a quarter in 2014. With regards to asset quality and foreign currency risk, banks have strengthened their loan appraisal processes and have stepped up their asset recovery efforts across 2014. As a result, and despite the 17.3% growth of domestic credit, the level of toxic assets in the system declined from its position a year ago. Banks have also managed their foreign currency risk within their risk-taking appetite and the pace of domestic activity expansion across 2014. Their overall open foreign currency exposure amounted to 11.8% of their capital, up slightly from the 9.1% exposure recorded 12 months ago, reflecting in part the pace of activity expansion, but down substantially from the allowable prudential ceiling of 25% of capital.

**Figure 5.1: Structure of Solomon Islands Financial System in 2014**



Meanwhile, improved domestic market conditions and operational efficiencies, particularly in the second half of 2014, have again boosted bank profitability in 2014. The cost of generating income declined 1.2 percentage points to 51.6% and about 55% of banks' total income came from their core business.

In line with this positive outcome, banks reinforced their capital position and other soundness indicators. Their tier 1 capital to risk-weighted assets amounted to 26.9%,

19.4 percentage points above the prudential floor of 7.5% while their total regulatory capital to risk-weighted assets amounted to 31.6%, 16.6 percentage points above the prudential floor of 15%. With these capital positions, the financial system had ample breathing space to contain risks in 2014 and support their transition to 2015.

Solomon Islands financial soundness indicators are shown on Table 5.1.

| Table 5.1: FSI Indicators   |         |         |         |         |
|---|---------|---------|---------|---------|
| FSI Indicators  | 2011    | 2012    | 2013    | 2014    |
| Tier 1 Capital (%)  | 28.5    | 24.9    | 26.5    | 26.9    |
| Min. Tier 1 Capital Requirement (%)   | 7.5     | 7.5     | 7.5     | 7.5     |
| Total Regulatory Capital (%)  | 30.9    | 33.2    | 32.4    | 31.6    |
| Min. Total Regulatory Capital Requirement (%)                                 | 15      | 15      | 15      | 15      |
| Liquid Asset Ratio (%)  | 55.9    | 59      | 57.2    | 54.6    |
| Liquid Assets to Total Assets (%)   | 67.8    | 69.9    | 66.9    | 64.4    |
| Open Foreign Currency Position to Capital (%)                                 | 5.2     | 3.9     | 9.1     | 11.8    |
| Max. Open Foreign Currency Position to Capital Requirement (%)                | 25      | 25      | 25      | 25      |
| Cost to income (%)  | 47.4    | 48.9    | 52.8    | 51.6    |
| Nonperforming loans to gross loans and advances (%)                           | 5.8     | 3.6     | 7       | 4.7     |
| Nonperforming loans (\$m)   | 67.4    | 44.7    | 101.4   | 79.2    |
| Total loan loss provision (\$m)   | 47.5    | 51.7    | 52.1    | 63.3    |
| Minimum provision for loan loss (\$m)   | 24.8    | 21.4    | 34.4    | 33.2    |
| Over/(short) provision for loan losses as per CBSI's provisioning requirement | 34.0    | 30.3    | 17.7    | 30.1    |
| Gross loans and advances, (\$m)   | 1170.90 | 1249.70 | 1439.60 | 1688.90 |

Source: CBSI

### Overview of the Financial System and Stability

The Solomon Islands financial system consisted of financial intermediaries including banks and non-bank financial institutions. Financial intermediaries perform the function of channelling funds from agents who have saved funds to agents who need funds or wants to borrow.

Across 2014, Solomon Islands financial sector had been resilient largely owing to its limited integration to international markets and to effective supervision by the Central Bank of Solomon Islands (CBSI). During the year, the financial sector also benefited from strong domestic liquidity position in the market. The regulatory and supervisory framework is generally strong in Solomon Islands.

However, while the financial institutions are well capitalized, strains appear to have emerged in the second half of 2014 as the domestic market begun to show some signs of stress. In particular, while GDP growth in the economy was positive, it failed to effectively trickle down to the real

economy. As a result, corporate client base has remained static across 2014 and banks are simply recycling the same corporate borrowers.

The developments in 2014, particularly the closure of Gold Ridge Mining Limited and the withdrawal of Westpac Bank from the logging sector, were cases in point. These two events had huge impacts on the business sustainability of banks and the overall stability of the system, as banks had little option to fill the vacuum that was created. This means the economy was not creating or expanding the base to support growth in the financial sector.

While the economy witnessed growth in private sector credit, the market and credit conditions for enterprises and households remained weak in 2014, reflecting weak economic sentiments and reluctance of banks to lend to the private sector households and enterprises, particularly to small and medium enterprises because of collateral and viability issues. Banks were taking a more selective approach in granting credit to enterprises and households.

### Financial System Development

The Solomon Islands financial system witnessed transformation, particularly in the introduction of modern electronic financial infrastructures which led to more branchless banking channels delivery of financial services and use of electronic means to settle payments. The country has ATMs that can do both cash-in and cash-out transactions; and establishment of in-store and mobile money agents both in rural and urban areas not previously serviced by financial institutions. Bank customers could access financial services without having to travel to urban centres but there were areas that are still not served as well. The year also saw a new bank licensed to add to the number of banks doing banking business in Solomon Islands.

Following the licensing of the new domestic bank, the financial system now hosts 4 commercial banks, 1 credit institution, 10 active registered credit unions, 4 insurance companies and 4 insurance brokers, 2 insurance agents, 1 superannuation fund, and 1 development bank. In an economy that has no stock market, these financial institutions play a vital role in the function of savings mobilization or in allocating the flow of funds and in providing private sector credit to the economy. Similarly, the soundness of these financial institutions is important to boost economic growth.

### Aggregated total assets of financial sector fell below trend over the past two years

The total assets of financial institutions in the financial system grew only by 5% during the year. This rate of growth is well below the rate of growths for years 2012, and 2013 of 29.4% and 15.5% respectively. As Table 5.2 below show these levels of growth in asset indicated some challenges in accumulation of financial assets in the financial system.

About 50% of the growth was contributed by the SINPF and followed by the commercial banks and Credit Corporation (SI) Limited.

| (\$'million)                | 2010          | 2011          | 2012          | 2013          | 2014          |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|
| Commercial Banks            | 2364.0        | 2989.1        | 3457.9        | 4009.9        | 4122.6        |
| SINPF                       | 1180.7        | 1324.9        | 1555.4        | 2467.1        | 2683.7        |
| Insurance Companies         | 110.7         | 120.3         | 117.5         | 124.4         | 126.0         |
| Credit Corporation [SI] Ltd | 32.5          | 69.3          | 87.1          | 113.1         | 134.0         |
| Credit Unions               | 43.2          | 51.7          | 49.7          | 50.6          | 52.6          |
| <b>Total Assets</b>         | <b>3731.1</b> | <b>4555.3</b> | <b>5267.6</b> | <b>6765.1</b> | <b>7118.9</b> |

Source: CBSI

The Table above also show the ranking of financial institutions in terms of asset size in 2014. Commercial banks take 58% of the total assets followed by SINPF with a share of 38%.

|                             | 2011       | 2012       | 2013       | 2014       |
|-----------------------------|------------|------------|------------|------------|
| <b>Commercial Banks</b>     | <b>3</b>   | <b>3</b>   | <b>3</b>   | <b>4</b>   |
| <b>Bank Branches</b>        | <b>13</b>  | <b>13</b>  | <b>12</b>  | <b>14</b>  |
| <b>Bank Agencies</b>        | <b>7</b>   | <b>7</b>   | <b>7</b>   | <b>7</b>   |
| <b>ATMs</b>                 | <b>36</b>  | <b>38</b>  | <b>38</b>  | <b>38</b>  |
| <b>EFTPOS</b>               | <b>175</b> | <b>224</b> | <b>306</b> | <b>347</b> |
| <b>Merchants</b>            |            |            | <b>72</b>  | <b>355</b> |
| <b>Mobile Bank Vehicles</b> | <b>2</b>   | <b>2</b>   | <b>2</b>   | <b>0</b>   |

Source: CBSI

In 2014, 247 merchants were established in Honiara while 108 were established in rural areas outside of Honiara and provincial centres. Merchants are basically acting as branchless banking agents of commercial banks.

### Regulatory and Supervisory Developments

Work to strengthen the laws to ensure that the supervisory regime in Solomon Islands is up to date with best international practices and standards progressed during the year. These legislations included the drafting of a new Financial Institutions Bill, the new Solomon Islands National Provident Fund Bill, the new Credit Union bill, and new Insurance bill. Working with the Economic Reform Unit (ERU) in the Ministry of Finance and Treasury, CBSI held consultations with stakeholders on the Credit Union Bill in 2014. The consultations covered the policy framework for the proposed changes to the regulatory framework for credit unions in Solomon Islands. The proposed new Credit Union legislation will enhance the operation and effective supervision of Credit Unions in Solomon Islands and will contribute towards the deepening of the financial services in the country. Credit Unions are financial institutions owned and managed by Solomon Islanders and could contribute positively to the credit allocation and encouraging financial savings of their members.

The Cabinet also approved the policy framework for the proposed new Financial Institution bill in 2014. This endorsement would now allow for the consultation with stakeholders to take place in 2015 as part of the legislative process. This reform is critical in the modernisation of the financial institutions law to enhance the supervision regime and support the development of financial services in Solomon Islands.

The Cabinet also endorsed the drafting of the SINPF bill in 2014. However, due to the recent change of Government, the Ministry of Finance and Treasury (MoFT) will resubmit to the Cabinet for endorsement of a drafting instruction before actual drafting commences. It is expected that MoFT will resubmit the draft in early 2015. As soon as the Cabinet endorses the draft, ADB and the Attorney General's Chamber will commence the drafting of the Bill.

Development of supervisory and regulatory infrastructure remains much a work in progress. CBSI have adopted new guidelines but major legislation reforms planned for the financial sector in 2014 were progressing at a slower pace than anticipated.

Two new guidelines were approved by the CBSI Board for implementation in 2014, while two new SINPF guidelines are in draft and expected to be approved in 2015. Prudential Guideline (PG9) on Complaints Management was issued to complement the Prudential Guideline 8 (PG8) on Disclosure of Fees, Charges and Interest rates. This new guideline is expected to provide a mechanism for consumers to exercise their rights by bringing their grievances to the attention of banks.

## Banking Sector

Despite the fall in net profit for two consecutive years, the banking sector remained strong and sound. The key performance indicators showed that the sector made profit which enabled them to maintain a capital buffer well above the minimum capital requirement and maintain a strong liquidity position.

The commercial banks profit slipped for two years consecutively and in 2014 it fell by 8% to \$77.9 million. The fall was due mainly to a rise in provision for bad debts by \$22 million and, to a lesser extent, the fall in net operating income due to drops in earnings from foreign exchange gains, fees and charges. As a consequence, Banks witnessed a narrowing of their ROA and ROE to 3% and 20% respectively.

Banks operating expenses grew in 2014 driven by the upsurge in depreciation and other expenses such as travelling and telecommunication expenses. Consequently banks cost to income ratio deteriorated to 60.9% in 2014 from 56% in 2013.

In terms of consolidated statement of financial positions, total assets of the banking sector grew by 3% to \$4,123 million in 2014. Loans and advances accounted for 17% of the

growth while cash and non-financial assets both grew by 19%. Loans and advances accounted for 38% of the balance sheet or 52.6% of total deposit in 2014.

**TABLE 5.4: Commercial bank Profit & Loss Statement trend, 2011-2014 (in millions of dollars)**

|                         | 2011  | 2012  | 2013  | 2014  |
|-------------------------|-------|-------|-------|-------|
| Net interest income     | 135.2 | 140.3 | 156.8 | 174.1 |
| Non-interest income     | 160.6 | 164.6 | 146.1 | 145.5 |
| Foreign exchange gains  | 104   | 111.9 | 98.1  | 96.0  |
| Fees & charges          | 31.6  | 33.3  | 33.5  | 28.0  |
| Others                  | 24.9  | 19.4  | 14.5  | 21.5  |
| Operating income        | 295.8 | 304.9 | 302.9 | 319.6 |
| Operating expenses      | 142.6 | 154.3 | 166.3 | 170.7 |
| Provision for bad debts | 19.6  | -0.2  | 2.4   | 24.0  |
| Profit Before Tax       | 133.6 | 150.8 | 134.3 | 124.9 |
| Profit After Tax        | 84.7  | 102.2 | 84.8  | 77.9  |

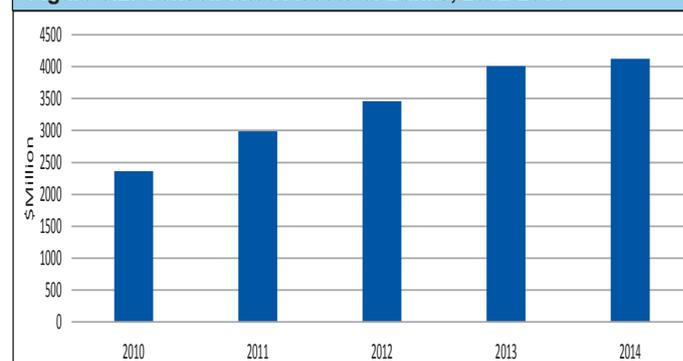
Source: CBSI

Lending grew by 15% in 2014. The growth came mainly from seven economic sectors, namely, Personal (37%), Distribution (15%), Telecommunication (12%), Construction (8%), Tourism and Professional services (7%), and Manufacturing (5%). Around 89% of banking sector lending was mainly in terms of funding for long term credits while 11% was for short term credit facilities like trade bills, overdrafts and lease financing.

Deposits continued to be the main funding sources for the banking sector, and accounts for 92% of total liabilities in 2014. Total deposits rose by 3% to \$3,209 million largely from growth in savings and time deposits. Non-financial corporation's accounted for a large portion of deposit with banks with private sector non-financial corporations accounted for 42% of deposits. Private sector individuals accounted for 21%, while other financial corporation's 18% and other sectors accounted for the remaining 19% of deposits in banks.

The banking sector remained well capitalized, with both regulatory capital to risk-weighted assets (regulatory capital adequacy ratio) and regulatory Tier 1 capital to risk-weighted assets (regulatory Tier 1 capital adequacy

**Figure 5.2: Consolidated Assets of Banks, 2012-2014**



Source: CBSI

ratio) in excess of the minimum statutory requirement of 15% and 7.5% respectively. Banks regulatory capital ratio stood at 31.7% while tier 1 capital inched up slightly to 27.3% from 26.8% in 2013.

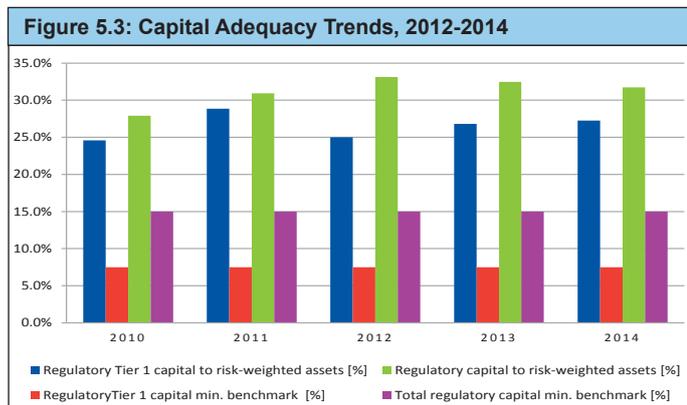
Total liquid assets for banks fell slightly to \$2,267 million in 2014 compared to \$2,311 million in 2013. The moderation in the liquidity position was reflected in the drop in

**Table 5.5: Consolidated Loans and Advances, 2012-2013**  
(In millions of dollars)

|                                | 2012          | 2013          | 2014          |
|--------------------------------|---------------|---------------|---------------|
| Manufacturing                  | 57.1          | 54.1          | 81.3          |
| Agriculture                    | 27.2          | 41.7          | 34.0          |
| Forestry                       | 55.0          | 43.5          | 29.0          |
| Fishing                        | 3.8           | 3.0           | 3.6           |
| Mining & Quarrying             | 5.1           | 0.1           | 3.3           |
| Construction                   | 189.7         | 181.9         | 151.7         |
| Distribution                   | 162.2         | 211.9         | 249.9         |
| Tourism                        | 80.1          | 103.4         | 107.2         |
| Transportation                 | 62.5          | 72.3          | 90.5          |
| Communication                  | 107.4         | 139.6         | 189.3         |
| Entertainment & Caterings      | 16.1          | 12.2          | 5.7           |
| Central Govt                   | 0.0           | 0.0           | 0.0           |
| Provincial & Local Govt        | 0.4           | 0.0           | 0.0           |
| Statutory Corporations         | 35.8          | 36.9          | 41.0          |
| Private Financial Institutions | 0.1           | 0.1           | 0.1           |
| Professional & Other Services  | 68.8          | 67.1          | 106.3         |
| Personal                       | 378.1         | 471.9         | 596.0         |
| Non Residents                  | 0.2           | 0.1           | 0.1           |
|                                | <b>1249.7</b> | <b>1439.6</b> | <b>1688.9</b> |

Source: CBSI

liquid assets to total assets ratio to 57% compared to 59% in 2013. While also witnessing the same trend in liquid asset to short term liabilities, slipping to 75% from 80% in 2013. Despite the drop, commercial banks were still flush with liquidity and have the ability to meet their obligations as they fall due.

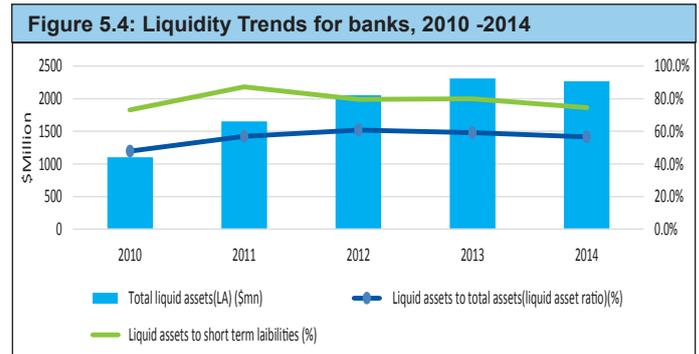


Source: CBSI

Asset quality of banks improved as indicated by the fall in the non-performing loans [NPLs] ratio from 7.2% in 2013 to 4.6% in 2014. In terms of volume, gross NPLs dropped by more than 25% from \$96 million in 2013 to \$72 million in 2014. The decrease in NPLs was particularly evident in

the construction and forestry sectors.

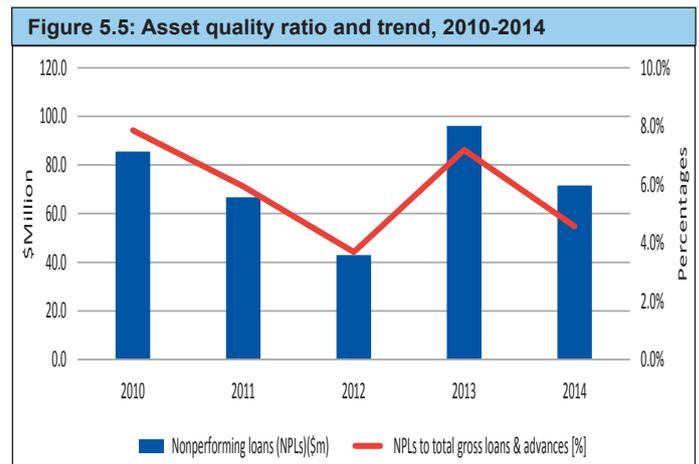
The banking sector's total provisioning (specific and general provisions), however increased to \$58 million at the end of 2014 compared to \$50 million in 2013. However, the increase covered only 81% of NPLs. Specific provisions to NPLs ratio registered 23% coverage in 2014. Nonetheless the banking sector continued to maintain adequate provisions over loan losses above the required minimum benchmark



Source: CBSI

### Credit Institutions

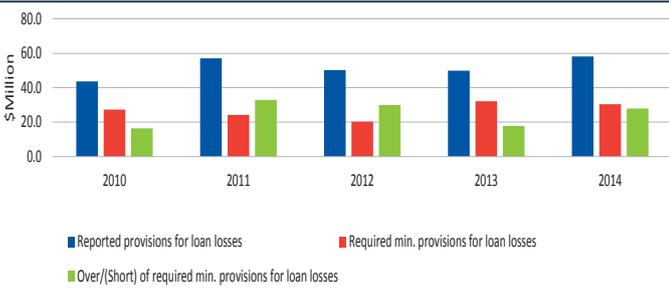
Credit Corporation Solomon Islands Limited (CCSIL) is the only licenced credit institution in the country in 2014. CCSIL is a branch of Credit Corporation of Papua New Guinea. While the institution accounted for a small proportion of the financial sector in terms of its asset size, it still played an integral role in the financial system in terms of financial intermediation. Since it started, the institution has enjoyed a continual positive growth year by year.



Source: CBSI

Total assets of CCSIL grew by 19% to \$134 million compared to the 30% growth in 2013. The easing of growth rate from 2013 to 2014 reflected moderate growth in the core lending activities, which is expected to ease further in 2015. On the liabilities side, total deposits grew by 43% to \$72.3 million.

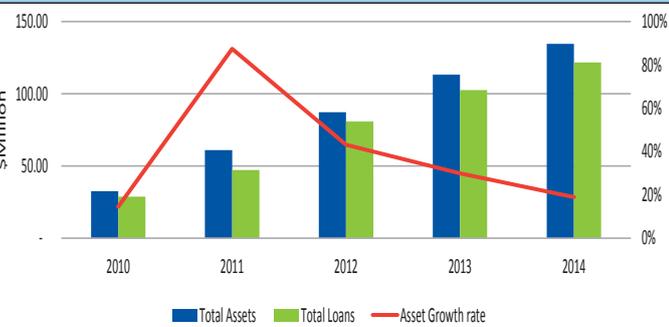
**Figure 5.6: Provisioning for loan Losses and Minimum benchmark, 2010-2014**



Source: CBSI

The value of classified loans for CCSIL rose to \$7.6 million from \$5.4 million in 2013. As a result the ratio of NPLs to totals loans was 6.2% from 5.3% in 2013. The increase in NPLs is consistent with the growth of the lending portfolio in during the year.

**Figure 5.7: Trend in Credit Corporation (SI) Limited asset growth, 2010-2014**

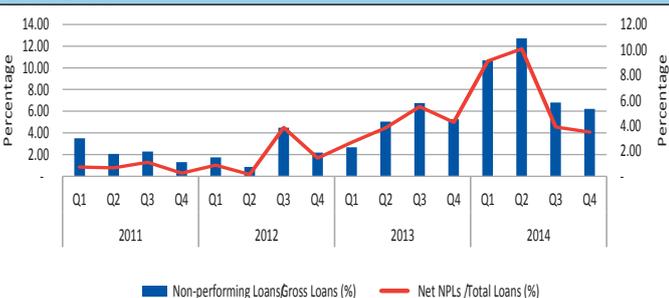


Source: CBSI

CCSIL's profitability fell to \$8.8 million in 2014. This compared to \$9.4 million in 2013. The fall in profit was attributed to increases in provisions for bad debts to \$3.3 million from \$1.9 million in 2013. As a consequence, the Return on Average Assets (ROAA), a measure of earnings, fell to 10.4% in 2014 from 13.2% in 2013.

Net interest margin (NIM) fell 18% in 2014, following 19.9% in 2013. Although net interest income was slightly up in 2014 (i.e. the numerator), the decline in NIM was mostly due to an increase in interest bearing assets (i.e. the denominator).

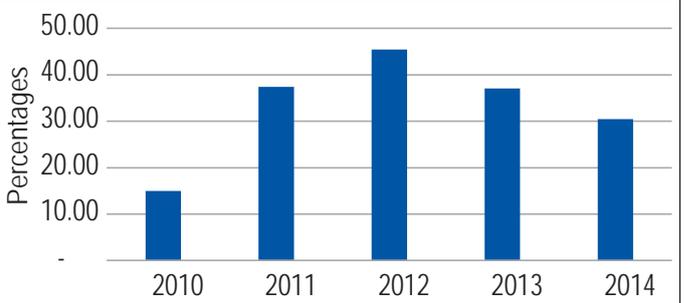
**Figure 5.8: Asset Quality of Credit Corporation (SI) Limited, 2011-2014**



Source: CBSI

The cost to income ratio of CCSIL rose to 37.5% from 29.2% in 2013. The increase largely reflected divergence of income and expenditures over the year with expenses on the rise while gross income fell.

**Figure 5.9: Net Interest Margin of Credit Corporation Limited, 2010-2014 (%)**



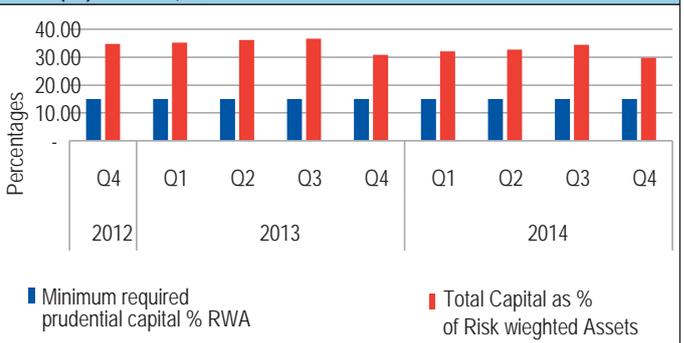
Source: CBSI

CCSIL was adequately capitalised. Its capital increased by 13% to \$38.4 million. Growth in capital was underpinned by the growth in retained earnings during the year. Although total capital grew during the year, the risk based capital ratio fell to 29.8% in 2014 compared to 30.9% in 2013 due to risk weighted assets growing faster than capital.

### Credit Union Sector

The Credit Union sector, despite its potential to grow and become competitive financial institutions in the country has muted growth since 2014. As at the end of the year only 10 of the 152 credit unions registered under the Credit Union Act 1987 were still operational but face many challenges. The rest of the registered credit unions are presumed dormant or defunct.

**Figure 5.10: Quarterly Capital Adequacy trend Credit Corporation (SI) Limited, Q4 2013 –Q4 2014**

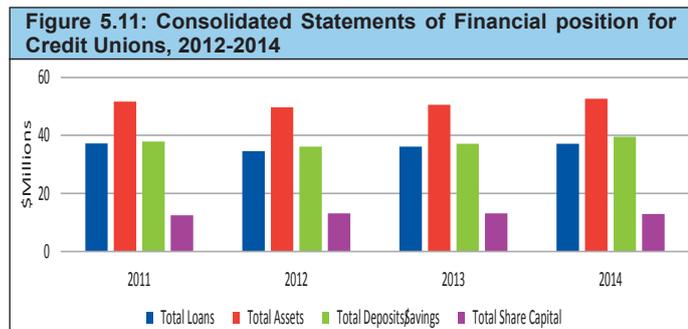


Source: CBSI

The consolidated balance sheet of credit unions grew by 4% to \$52.6 million from a year ago. This growth rate was consistent with 3% growth in loans for the same period in 2013. Total loans to members rose to \$37.1 million in 2014 from \$36 million in 2013. However since 2011, the growth has generally been very flat, meaning that the sector is stagnant and badly needs new direction and management visions to grow membership, services and products to

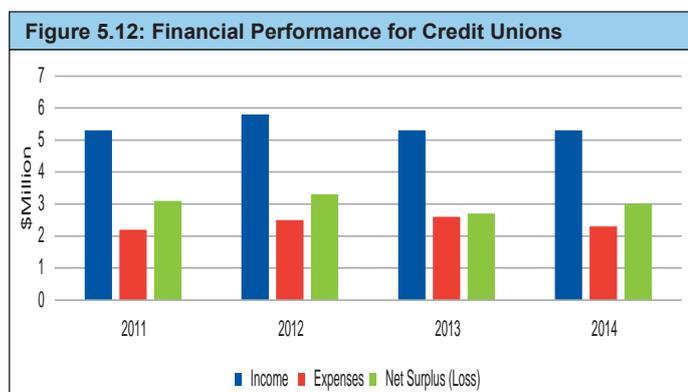
members.

The aggregate profit of credit unions rose by 11% to \$3 million in 2014 following a fall in 2013. The positive performance was attributed to a fall in operating expenses. But the revenue stream of the credit unions remain flat during the year despite the increase in earning assets and loans, indication that the net interest margin was declining.



Source: CBSI

In the absence of a credible data, asset or loan quality was gauged by the growth in revenue against the growth in loans. It is anticipated that profitability would track loan growth closely due to the legal requirement that Credit Unions were only allowed to lend at 12% interest per annum. However revenue in 2014 did not show growth which means that some portion of the loans were non-performing.



Source: CBSI

In 2014, the ADB assisted CBSI in reviewing the Credit Union Act (1986). The consultation on the new Credit Union Bill was completed in mid-2014 and a new policy framework was finalised in November 2014. Following this ADB has prepared the drafting instructions for Cabinet and this is anticipated to be submitted in the first half of 2015. The new credit union law, once enacted, would provide a robust regulatory and supervisory framework and at the same time would address operational, financial and administrative issues specific to credit unions.

Apart from the legislative and regulatory reform, it will be important, particularly in the short term, that a comple-

mentary program of capacity support be developed and implemented to address the critical issues currently facing credit unions in Solomon Islands, including those related to good governance and prudent financial management. It would also be crucial to consider merging of some of the credit unions into one larger credit union to consolidate strengths in membership, efficiency and management of these institutions.

Solomon Islands Credit Union League (SICUL), the umbrella body for all credit unions in Solomon Islands, did not perform its function in 2014. SICUL did not organize or conduct trainings or workshops for its members as its manager had left unexpectedly for his home province in early 2014 leaving SICUL with a mountain of unaccomplished tasks. Meanwhile the SICUL Board too lacked commitment in executing its oversight function and in providing strategic directions to SICUL management in terms of solidifying credit union movement in Solomon Islands. The issue of whether credit unions should be forced to become members of a parent body created by the Act or form their own voluntary league is a matter that will be addressed in the new credit union law.

Under a Memorandum of Understanding that CBSI and SICUL Board signed in April 2013, the former would provide an annual budget support of \$310,000 to SICUL. The support was aimed at smoothing the operations of SICUL but that it was conditioned on SICUL submitting its annual business plan and quarterly performance reports to CBSI. Unfortunately, due to the sudden departure of SICUL’s manager and an apparently lack of commitment by SICUL Board, CBSI did not receive the quarterly performance reports in 2014. As a consequence, no budget support disbursement was made in 2014. CBSI’s budget support to SICUL will expire at the end of 2015.

**Superannuation Sector**

The Solomon Islands National Provident Fund (SINPF) established by the National Provident Fund Act 1973 and commenced operations on 1 October 1976. SINPF is the only superannuation and the largest supervised financial institution in the country and accounts for 37% of financial assets of the financial system.

SINPF recorded an audited profit of \$117 million at the end of its financial year ending 30<sup>th</sup> June 2014 compared to \$776 million for the same period in 2013

**Table 5.6: Income table (audited) for SINPF, 2011-2014**

| For the Period ending June (\$ million) | 2011  | 2012  | 2013  | 2014  |
|---|-------|-------|-------|-------|
| Investment Income                       | 129.4 | 125   | 836.1 | 161.1 |
| Investment Expense                      |       |       | 27.8  | 20.7  |
| Net return on investments               |       |       | 808.3 | 140.4 |
| Other Income                            | 6.1   | 12.9  | 4.0   | 21.1  |
| Total Income                            | 135.5 | 137.9 | 812.2 | 161.5 |
| Operating Expenditure                   | 47.6  | 49.3  | 36.2  | 43.7  |

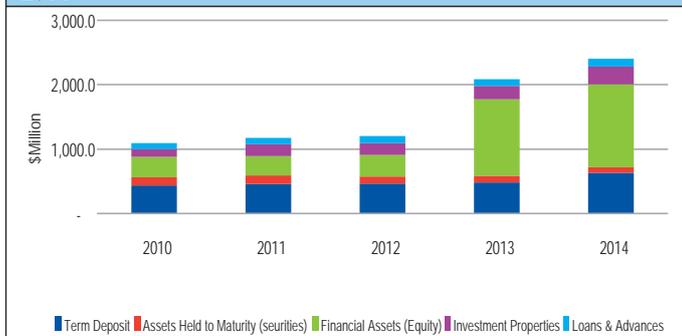
|                          |      |      |       |        |
|--------------------------|------|------|-------|--------|
| Gross Surplus            | 87.9 | 88.6 | 776.0 | 117.8  |
| Appropriation to Members | 78.9 | 64   | 246.6 | 236.2  |
| Net Surplus/(Loss)       | 9.0  | 24.6 | 529.4 | -118.4 |

Source: CBSI

On the calendar year 2014 basis SINPF experienced subdued performance of some of the main investment classes in 2014, particularly earnings from share equities and its lending, from 12 calendar months to December 2014. Some of the SINPF equity shares posted revaluation losses, while poor loan quality and negative developments in the global market took a toll on foreign investments performance.

Measuring the performance in terms of its financial year outcome, earnings (ROE and ROA) have both fallen to 20.5% and 5.3%, respectively, in June 2014.

**Figure 5.13: SINPF Investment Portfolio trend for years 2010-2014**

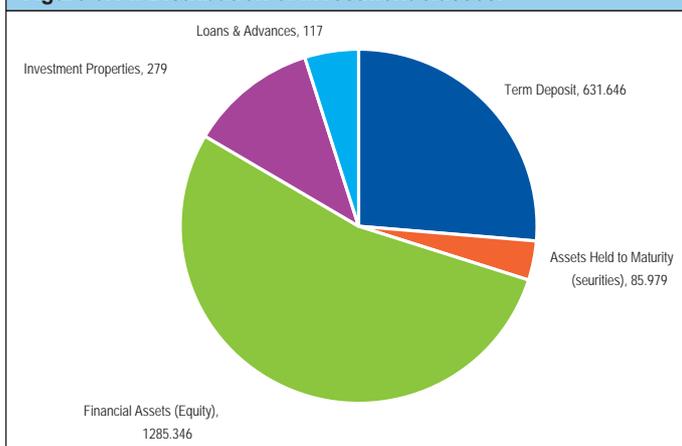


Source: CBSI

SINPF's total assets increased further by 9% to \$2,683.7 million at the end of 2014, following a sharp growth in 2013. Growth in assets was attributed to growth in investment portfolio due to acquisition of Cable and Wireless (C&W) shares in Our Telekom and also from a fresh debenture bond investment in SolTuna Limited.

Shares and equities remained the dominant class of investment and accounted for 53% of the portfolio, while

**Figure 5.14: Distribution of investment classes.**

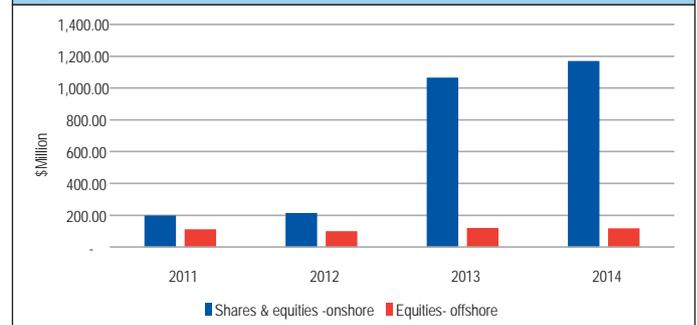


Source: CBSI

term deposits with banks took second position at 26%. Investment properties accounted for 12%, debt securities 4% and loans 5%.

Assets held to maturity fell in 2014 as a result of unfavourable conditions in the global market and early settlement of domestic securities. A dip in fair market values in shares from some of the SINPF portfolios impacted on the overall growth of the financial assets.

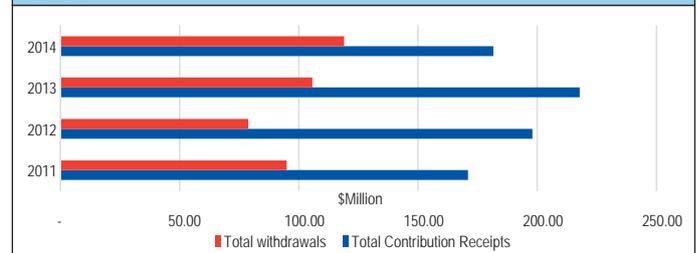
**Figure 5.15: Changes in fair value of shares and equities 2011-2014**



Source: CBSI

Total membership contributions grew by 5% to \$2,099 million in 2014. Part of this growth in contributions came from the 18% crediting rate awarded to members in June 2014. Finally, with regards to membership withdrawals, much of the withdrawal in 2014 came primarily from the retirement and migration grounds.

**Figure 5.16: Member contribution and withdrawal trend 2011-2014**



Source: CBSI

### The Insurance Sector

The insurance industry was stable and remained resilient despite the April floods. The industry also had its first life insurance business registered by the Office of the Controller of Insurance. It would be a first life insurance company registered for a number of years. Overall, the insurance sector remained sound despite a slow growth in premiums at the back of increasing motor vehicle claims (see Table 5.7).

**Table 5.7 Consolidated Financial Statement for Insurance**

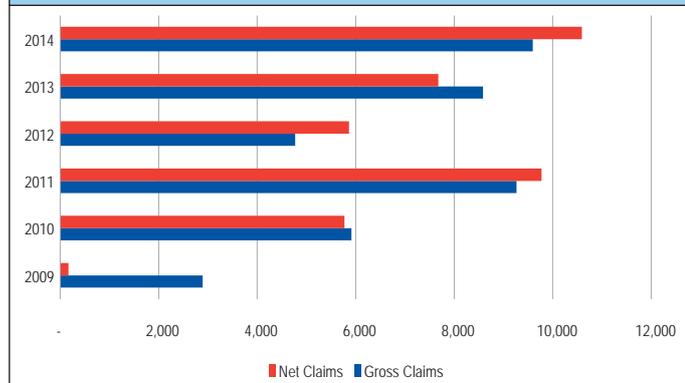
| Income Statement (\$millions) | 2010 | 2011  | 2012 | 2013 | 2014 |
|-------------------------------|------|-------|------|------|------|
| Gross premium                 | 60.6 | 60.0  | 48.7 | 68.9 | 72.6 |
| Reinsurance                   | 16.0 | 14.4  | 9.0  | 15.8 | 17.2 |
| Premium Reserve               | 1.6  | (0.3) | 3.8  | 2    | .694 |
| Net Earned Premium            | 43.0 | 45.9  | 35.9 | 51.1 | 54.7 |

|                                     |       |       |        |       |       |
|-------------------------------------|-------|-------|--------|-------|-------|
| Total Premium Expense(Incl. Claims) | 12.5  | 15.3  | 10.8   | 15    | 18.7  |
| Underwriting Income                 | 30.4  | 30.6  | 25.1   | 36.1  | 36    |
| Management Expense                  | 5.8   | 6.6   | 6.2    | 8.3   | 11.5  |
| Non-Underwriting In[come]           | 2.0   | 1.3   | (0.06) | 0.3   | 0.27  |
| Net Profit Before Tax               | 26.6  | 25.3  | 18.9   | 28.1  | 24.8  |
| Net Profit After Tax                | 16.8  | 16    | 12.3   | 18.3  | 15.9  |
| Balance sheet(\$millions)           |       |       |        |       |       |
| Total Assets                        | 110.7 | 120.3 | 117.5  | 124.4 | 126.0 |
| Total liabilities                   | 45.2  | 38.7  | 50.4   | 49.3  | 55.1  |
| Net Assets                          | 65.5  | 81.6  | 67.1   | 75.1  | 70.9  |

Source: CBSI

Net earned premium increased during the year. This was driven by premium on fire, liability, marine and householder’s class of business. General liability class of business recorded a total of \$1.1 million compared to \$0.2 million in 2013. Net earned premium totaled \$54.7 million, an increase of \$3.7 million from 2013. Gross premiums of the local insurance industry stood at \$72.6 million in 2014, an annual increase of 5.3 percent. Amounts paid for reinsurance offshore totaled \$17.2 million, compared to \$15.8 million in 2013. The increase was driven by a number of new policy holders that took cover against fire which accounted for 80% for the total followed by householders at 7%, construction all risk class at 4%, marine and liability classes 3% and the rest to others.

Figure 5.17: Trend in the Insurance claims, 2009-2014

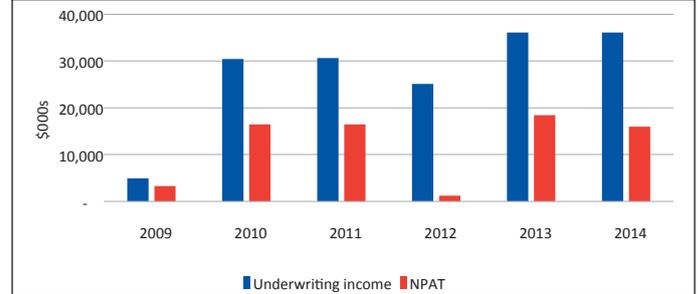


Source: CBSI

Motor vehicle and fire classes of insurance topped the gross claim in 2014. The industry paid out a total of \$9.6 million in gross claims, of which motor vehicle and fire classes of business accounted for 27% and 26% respectively.

Total assets for the industry were \$126 million as at the end of 2014, an increase of \$1.6 million (1 percent) from 2013. The increase in total assets was due to increases in receivables and debt securities. In line with the increase in

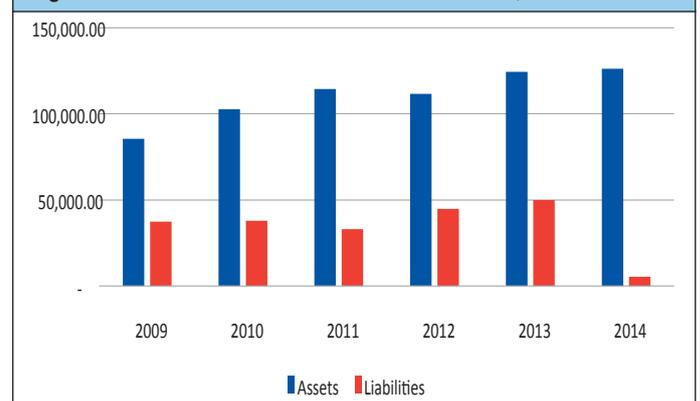
Figure 5.18: Trends in Operations & Underwriting Results, 2009-2014



Source: CBSI

assets, there was a 112% increase in the non-financial assets which accounted for \$1.9 million as compared to \$0.93

Figure 5.19: Trends in total assets and liabilities, 2009-2014



Source: CBSI

million in 2013.

Industry liabilities also continued to trend upward and in 2014 posted an annual increase of 12% following a 10% increase in 2013. The major surge was driven by other liabilities, which recorded a rise of 134%. This significant increase was prominent in liabilities due to agents & brokers as well as to the Head Office accounts. Total capital of the insurance industry declined in 2014. The decline was due to a fall in retained earnings, which recorded a reduction of 24% from \$75.1 million in 2013.

## CHAPTER 6: COMBATING MONEY LAUNDERING AND FINANCIAL CRIMES

The Solomon Islands Financial Intelligence Unit (SIFIU) is established under the Money Laundering and Proceeds of Crime Amendment Act 2010 (MLPCAA 2010). The role and functions of SIFIU are provided under the MLPCAA 2010. SIFIU is one of the leading agencies in Solomon Islands that is primarily responsible for preventing and detecting money laundering and terrorist financing activities. The Unit has four (4) officers, three seconded officers of the Central Bank and one seconded officer from the Ministry of Police, National Security and Correctional Services. In terms of operational functions; the SIFIU reports to the Anti-Money Laundering Commission (AMLC), established under section 11 (1) of the MLPCAA 2010. The Attorney General of Solomon Islands chairs the AML Commission.

The Solomon Islands anti-money laundering regime has continually carried out its obligations to fight money laundering and terrorism financing activities. This is evident from the good ratings it received for the majority of the Financial Action Taskforce (FATF) core and key recommendations contained in the 2009 World Bank report. Solomon Islands have also been given positive and commendable ratings for its follow-up reports on the subsequent years after the 2009 mutual evaluation by the Asia Pacific Group (APG). Whilst Solomon Islands cannot claim to be freed from money laundering and terrorism financing activities, we can confidently say that we have an Anti-money laundering regime that is functioning well with control mechanisms in place to make it difficult for criminals to misuse the financial system. The SIFIU is committed to carrying out its obligations to ensure Solomon Islands is protected from money laundering and terrorism financing activities.

### Membership to International Anti Money Laundering Groups provides support to work of SIFIU

SIFIU is a member of the APG on Money Laundering and also a member of the EGMONT Group. As a member of these international and regional organizations, the SIFIU and the AMLC are committed to performing their responsibilities to meet International AML/CFT standards and requirements. In addition being members of these international bodies ensures that Solomon Islands stays current with the best practices of combating money laundering and anti-terrorists financing.

### Financing of SIFIU operations comes from the Government

The Solomon Islands Government funds the operations of the SIFIU and the AMLC through budgetary provisions from the Ministry of Justice and Legal Affairs. In 2014, the financial support to SIFIU provided by the Government totalled \$709,800. This is a 5% increase from 2013 funding. SIFIU expended \$642,509.20 for its operation in 2014 which is 90.5% of the total funding received from the government.

SIFIU maintained regular contacts with reporting agencies

The SIFIU maintained close working relationships with the reporting agencies during the year. Quarterly meetings were held with the AML reporting officers from the four commercial banks in the country, ANZ, BSP, POB and Westpac to discuss AML/CFT issues. It was encouraging to note that financial institutions in the country are playing their part in ensuring that the financial system of the country is free from money laundering and terrorism financing activities.

### Advising Public against Financial Scams

The SIFIU in 2014 was again involved in advising the public against "financial scams". The Unit attended to numerous queries from the public during the year on false financial schemes and purported lottery wins. Two of the most widely known fast money making schemes that SIFIU has continuously warned the public against were Five (5) Golden Dreams Investment and the JJ Ark Investment. SIFIU was able to provide expert advices to those who sought advice from the Unit prior to making payments to promoters of the money schemes either locally or offshore. Unfortunately, some people had sought advice after they had already paid and lost their money to the perpetrators.

### Numbers of suspicious transactions (STRs) referred to the Police for further investigation increase

The number of Suspicious Transaction Reports (STRs) received increased from 28 in 2013 to 32 in 2014, and the number disseminated increased from 5 in 2013 to 14 in 2014. These were increases of 14.3% and 180% respectively. Contributing to the increase in the analysed STRs disseminated to the LEAs is the increase in the staffing level from 2 in the previous years to 4 in 2014. Increases were also notable for the Cash Transaction Reports (CTRs), Electronic Funds Transfer Reports (EFTRs) and Border Currency Reports (BCRs) in 2014.

| Type of Reports                         | Received |        | Disseminated |      |
|---|----------|--------|--------------|------|
|   | 2014     | 2013   | 2014         | 2013 |
| Suspicious Transaction Report (STR)     | 32       | 28     | 14           | 5    |
| Cash Transaction Report (CTR)           | 54,399   | 52,129 | 0            | 0    |
| Electronic Funds Transfer Report (EFTR) | 15,628   | 13,364 | 0            | 0    |
| Border Currency Report (BCR)            | 77       | 42     | 2            | 0    |

Source: CBSI

### Meeting of the AMLC held during the year

During the year the AMLC met four (4) times. Attendance by members of the AML Commission was 75%. The AMLTEG and the AMLRO also met four (4) times respectively during the year with very good meeting attendance

by all member institutions.

### Overseas Trainings/Workshops and Meetings Attended

The Table 6.2 below show the number of training courses and workshops attended by the SIFIU and supporting institutions in Solomon Islands.

| Date                  | Country               | Workshop/ Meeting   | Attendees   |
|-----------------------|-----------------------|---|---|
| 2014 January          | Auckland, New Zealand | Pacific Assessors, Risk Assessment & Typologies Training in | Ronald Talasasa<br>Jimmy<br>Joseph Poleita Mataki |
| 23/06/014-02/07/2014  | Suva, Fiji            | Training Attachment with Fiji FIU                           | Jimmy Vaja<br>Peter Damien Tura                   |
| 14/07/2014-19/07/2014 | Macao China           | APG Plenary   | Jimmy Sendersley                                  |
| 24-28 Nov 2014        | Thailand              | Typologies  | Augustine Aulanga<br>Jimmy Sendersley             |

Source: CBSI

### Local Training and Workshops

The Unit also conducted workshops for local stakeholders in the country as shown in the Table 6.3 below.

| Date       | Workshop/Training | Attendees                |
|------------|-------------------|--------------------------|
| 2/5/2014   | Workshop          | Law Enforcement Agencies |
| 14/08/2014 | Workshop          | Financial Institutions   |
| 09/12/2014 | Workshop          | Credit Unions in Honiara |

Source: CBSI

## CHAPTER 7: FINANCIAL INCLUSION

Despite the good progress made in doubling its numerical targets for new bank accounts; establishment of its bank led model of branchless banking infrastructure, the National Financial Inclusion Taskforce still faces challenges in delivering financial education in the national school curriculum, promoting active consumer empowerment and protection; conducting adult financial literacy in the use of the branchless banking technology, and introduce a micro insurance scheme that would be affordable to the poor.

### Numerical target of 70,000 new bank accounts by 2015 exceeded

At the end of December 2014, the accumulative total of new bank accounts opened for Solomon Islander bank customers since 2011 reached 135,581, almost double the 70,000 target to be achieved in 2015 by the National Financial Inclusion Taskforce (NFIT). Fifty-four percent of the accumulative total new accounts were opened in 2014. This effectively means that in just one year, the 70,000 new accounts planned for a 5 year period were achieved in 2014 alone.

What drove the outcome was the use of branchless banking infrastructure which was commissioned towards the end of 2013, and the simplification of Know Your Customer (KYC) identification requirements by the Anti-Money Laundering Commission (AMLC) which allowed commercial banks, to open personal accounts for first time applicants without having to infringe the anti-money laundering law. Banks used tablets in their in-store agents and mobile banking agents to open accounts for their customers in areas where they would not have been able to do so under the old banking infrastructure model.

With the numerical goal for new accounts achieved earlier than planned (see Table 7.1), NFIT decided to raise the numerical target to 160,000 new accounts to be opened for Solomon Islanders by the end of 2017. The objective is to ensure 80% of the adult population have bank accounts and access to financial services.

|  | 2011  | 2012   | 2013   | 2014    |
|--|-------|--------|--------|---------|
| Total new deposit accounts opened at bank branches   | 8,235 | 21,896 | 16,788 | 44,276  |
| Total new accounts opened using branchless banking channels (Mobile Merchants, In-Store and Tablets) | 0     | 0      | 15,127 | 33,749  |
| Total new accounts opened each year  | 8,235 | 21,896 | 31,915 | 78,025  |
| Total year to date   | 8,235 | 30,131 | 62,046 | 140,071 |

Source: Commercial Bank Reporting Templates

Other factors that contributed to achieving the numerical target ahead of the time-frame deadline are: During the



The Royal Solomon Islands Police Band members were part of the Financial inclusion Expo program in June 2014. Photo by Gane Simbe

year, a new bank was licensed, this also contributed to the increase in new accounts being opened and additional financial access points and services to banking customers particularly in Honiara. There were on-going investments by telecommunication companies specifically the mobile network operators to provide the underlying infrastructure that enabled commercial banks to provide mobile phone banking or branchless banking services. The telecommunication towers in rural locations also enabled 80% of the population to access mobile phone services.

The continual support in both technical and financial assistance provided by the Pacific Financial Inclusion Program (PFIP), Alliance for Financial Inclusion (AFI), supported by Bill & Melinda Gates Foundation, Pacific Islands Regional Initiative (supported by AFI and central banks in the South Pacific region) on financial inclusion; and donor partners particularly DFAT/AusAid, UNCDF, NZAid; and bilateral and multilateral institutions such as Asian Development Bank; International Finance Corporation (IFC) and the World Bank; and the support provided by the Solomon Islands Government, and other stakeholders to pursue this policy agenda. The outcome of these support and policy agenda slowly transformed the country's financial delivery channels from brick and mortar to establishments of branchless banking agents, and as well as increasing penetration of banking in the rural area as shown in Table 7.2.

| Name of Indicator                 | Choiseul | Western | Isabel | Malaita | Guadalcanal | Central | Makira | Renbel | Temotu | Honiara | TOTAL |
|-----------------------------------|----------|---------|--------|---------|-------------|---------|--------|--------|--------|---------|-------|
| No of Bank Branches               | 0        | 4       | 0      | 2       | 0           | 0       | 0      | 0      | 0      | 8       | 14    |
| No of ATMs                        | 0        | 7       | 0      | 2       | 1           | 0       | 0      | 0      | 0      | 28      | 38    |
| No of EFTPOS (excluding In-store) | 4        | 44      | 3      | 19      | 6           | 6       | 6      | 0      | 3      | 239     | 330   |
| No of In-Store Banking            | 1        | 6       | 1      | 2       | 2           | 2       | 1      | 0      | 2      | 7       | 24    |

|  |    |    |    |    |    |    |    |   |   |     |     |
|--|----|----|----|----|----|----|----|---|---|-----|-----|
| No of Bank Agents  | 1  | 4  | 1  | 3  | 0  | 0  | 1  | 0 | 1 | 0   | 11  |
| No of Mobile Financial Services (MFS) agents and Merchants | 5  | 22 | 6  | 13 | 19 | 6  | 9  | 1 | 3 | 37  | 122 |
| Total access points per Province                           | 11 | 87 | 11 | 41 | 28 | 14 | 17 | 1 | 9 | 319 | 538 |
| Total Access Points (2013)                                 | 6  | 87 | 11 | 41 | 28 | 11 | 14 | 1 | 8 | 298 | 439 |

Note: Data extracted from the Commercial Bank Reporting Template (NFIU)

### Microfinance Company continues to grow

The only private microfinance (MFI), foreign owned company, continually improved and registered new clients since its inception in 2013. In 2014, the company disbursed more than 2000 small uncollateralized loans to its women clients, worth more than \$12 million. The Company focused on providing micro credit to assist and empower women to graduate from poverty through financial access and responsible management of their financial resources.

### Rural Saving Clubs saw growth in numbers, membership and financial assets.

Based on data reported by NGOs, 2014 witnessed further growth of saving clubs in terms of numbers, membership and amount saved. Table 7.3 shows the number, location and the size of these savings clubs around the country.

| Indicators                     | 2013 | Choiseul | Western | Isabel | Malaita | Guadalcanal | Central | Makira | Renbel | Temotu | Honiara | TOTAL |
|--------------------------------|------|----------|---------|--------|---------|-------------|---------|--------|--------|--------|---------|-------|
| Number of saving Clubs         | 118  | 1        | 16      | 18     | 45      | 12          | 1       | 18     | 3      | 10     | 15      | 139   |
| Number of Saving Club Members  | na   | 28       | 849     | 506    | 1792    | 235         | 60      | 491    | 36     | 408    | 307     | 4712  |
| Number of Women Savers         | na   | 17       | 849     | 407    | 1427    | 141         | 15      | 300    | 36     | 209    | 242     | 3643  |
| Total Value of Saving (\$'000) | na   | 8        | 254     | 519    | 777     | 108         | na      | 331    | 3      | 71     | 152     | 2,521 |

Source: NFIU stakeholder's reporting template

These rural saving clubs provide basic financial products and services to their members, including savings accounts and even small credit.

With the remoteness of village communities from urban centres, CBSI sees savings clubs as potential financial service providers to remote rural communities. In pursuing this option, CBSI in partnership with PFIP commissioned a study on the current practices of the saving clubs with the aim of identifying the gaps and working towards

the promotion of best practices to stimulate sustainable growth of savings clubs in remote locations in Solomon Islands. The study was concluded in mid-2014 and the study findings were submitted to NFIU for implementation. Savings Club promoters were empowered through training and guidance to enable them to review their policies and practices towards promoting best practices and ensuring sustainability.

### Financial Literacy

Overall, financial inclusion agendas continue to progress but it is still a long way to go and more needs to be done.



A young entrepreneur prepares a 'hot dog' for sale during the Youth@work Market at the Art Gallery 2 May 2014. Providing employment or business opportunities for its growing population of young people who finished from education institutions remains a challenge for successive Governments for many years. Photo by CBSI

### Financial Education

The goal to have financial education taught as part of the formal education curriculum in primary to secondary schools failed to progress in 2014. The bottle neck to progress was due to changes made by the Ministry of Education and Human Resources Development (MEHRD) to the position of the Director of Curriculum Development. MEHRD plans to follow up this goal in 2015, however, each year this project is delayed, Solomon Islands will fall behind its regional Pacific members in educating its children and youth in financial education. This is one of the CBSI's Maya Declaration commitments' that has been off track because of the reasons above.

### Measuring financial inclusion outcomes

The "PIRI Core Plus" data set to measure the progress of

the financial inclusion activities in Solomon Islands is now in full operation but only the supply-side data is currently being provided. Working with its PFIP, AFI and members of PIRI, the demand side survey funding, and preparation for survey was intensified during the second half of 2014. A contractor was selected to carry out the survey while NFIT; was given the responsibility to advertise and select the enumerators for the survey. The survey was expected to be conducted early in the first half of 2015. The outcome of the survey will enable the CBSI and NFIT to tabulate the data related to demand for financial services in Solomon Islands by the second half of 2015.

This is the second CBSI Maya Declaration goal that is tracking well despite the progress to collect the demand for financial services data being delayed for a year.

The objective to introduce affordable micro insurance products to low income population in Solomon Islands achieved little progress.

This policy objective is one of the commitments made by the Central Bank of Solomon Islands in its MAYA Declaration. Unfortunately progress in achieving this goal

has been slow for various reasons. First, the size of the insurance market in Solomon Islands is very small and shallow. The lack of competition in the market for micro insurance products makes this objective a long term objective to achieve. To achieve this goal will require educating the people to be risk conscious and promote the habit to mitigating risks.

**Consumer empowerment and protection goal achieved muted progress**

Consumer empowerment and protection remains a challenging goal for NFIT. The progress made during the year involved information gathering from commercial banks and encouraging banks to conduct awareness of their products; in line with the Prudential Guideline No.8 which requires banks and credit institutions to disclose interest rates, fees and charges of all their products and services. Secondly, Prudential Guidelines No. 9 is on Complaints Management. The objective of the guideline is to provide financial and credits institutions a minimum framework for complaints management, to ensure that customer complaints are promptly investigated and resolved in a satisfactory manner.



Kukudu Adventist College and Gizo Community High School students march with their banners on the streets of Gizo town, to mark the Consumer Day organised by the Ministry of Trade and Commerce on 28 May 2014. Consumer empowerment and protection is one of the policy goals of the National Financial Inclusion Taskforce and its achievement requires cooperation from other stakeholders. Photos by Linray Tutuo.

## CHAPTER 8: CALENDAR OF EVENTS 2014

| Month     | Events  |
|-----------|---|
| January   | Governor and Deputy Governor addressed CBSI staff as part of 2014 staff orientation.  |
| February  | First CBSI Board meeting for 2014 convened<br>Senior Investment Officer attended a one week BIS Reserves Management Workshop, Osaka, Japan.<br>Board Audit Committee (BAC) held its first Meeting<br>Handover of 3 new staff houses at Mbokona  |
| March     | Deputy Governor, Manager, NFIT and Statistic Officer NFIT attended PIWG and AFI Meeting in Nadi, Fiji<br>Second CBSI Board meeting convened.<br>One staff sent for medical treatment in PNG.<br>Publication of March 2014 Monetary Policy Statement<br>Financial Markets Department carried out onsite examination of SolTuna Credit Union Limited at Noro Western Province.<br>Analyst (Insurance) of Financial Markets participated in the onsite examination of Westpac Bank (Fiji) Ltd in Suva, Fiji  |
| April     | Heavy rains caused destructive flooding in Honiara and Guadalcanal and led to the closure of Gold Ridge Mining Limited.<br>Audited Financials and Operations for 2013 submitted to Minister of Finance.<br>Third CBSI Board meeting convened.<br>Customer service training for front desk staff from Currency and Banking and International Department, and Administrative Assistants at Solomon Host.<br>New police officer seconded to Solomon Islands Financial Intelligent Unit.<br>Senior Analyst (Credit Union) participated in the onsite examination of NASFUND in Port Moresby, Papua New Guinea   |
| May       | Governor attended the Asian Development Bank (ADB) annual meetings in Astana, Kazakhstan.<br>Deputy Governor attended National Stakeholders Consultation for Pacific Regionalism.<br>Fourth CBSI Board meeting convened.<br>IMF second program review mission visited Solomon Islands.<br>New Compliance officer & Monitoring Officer recruited for the International Department<br>Floor wardens of CBSI attend Emergency Procedure training Course at the Correctional service training centre at Rove.<br>Financial Markets Department conducted onsite examination of Westpac Banking Corporation (SI) Ltd  |
| June      | Governor launched the 2013 Annual Report in Honiara<br>The High Court of Solomon Islands extended CBSI's role as Court Appointed Manager (CAM) of DBSI for two years.<br>CBSI participated in the National Financial Inclusion Expo held at the Art Gallery.<br>Snr Analyst (Banking Unit) attended the ANZ Supervisory College in Sydney, Australia.   |
| July      | Governor attended the 2014 Forum Economic Ministers Meeting in Honiara, Solomon Islands.<br>Governor attended PFTAC Steering Committee meeting in Nadi, Fiji.<br>Governor officially opened Pan Oceanic Bank (POB) operations in Solomon Islands.<br>Finance and Account and Information Technology departments held meeting with TechOne on installation new financial system software for the Bank.<br>Manager Financial Markets Department attended course at the Boulder Institute of Microfinance in Turin, Italy  |
| August    | Chief Manager Economic Research Department and Deputy Governor attended the 6th Australia Solomon Islands Business Forum & Trade Expo in Brisbane, Australia<br>Deputy Governor attended a 'Responsible Digital Finance Forum' in Perth, Australia<br>CBSI Board Audit Committee held its 2nd meeting.<br>IMF MCM TA Mission on Exchange Rate Arrangements and Monetary Policy Implementation.<br>Fifth CBSI Board meeting convened.<br>New ODI officer welcomed as another farewelled after his term with the Bank.<br>Bloomberg FX tools training hosted by International dept.<br>Markets Department conducted onsite examination of Solomon Islands Health Workers Credit Union Limited   |
| September | Deputy Governor, attended G20 Subcommittee on Financial Inclusion in Perth, Australia.<br>A Special CBSI Board Meeting convened.<br>Governor attended the Alliance for Inclusion (AFI) Global Policy Forum in Port of Spain, Trinidad & Tobago.<br>Sixth CBSI Board meeting convened.<br>IMF TA Team Review of Exchange rate Arrangements and Monetary Policy Implementations<br>Security officer attended visions system security training.<br>M/HR attended "counselling" course in NZ<br>Publication of September 2014 Monetary Policy Statement<br>Financial Markets Department did an onsite examination of Tower Insurance (SI) Ltd.<br>Chief Manager and Senior Analyst (Banking Unit) of Financial Markets Department attended the 2014 Annual Meeting of the Association of Financial Supervisors of Pacific Countries in Port Moresby, Papua New Guinea |
| October   | Governor attended the IMF and World Bank annual meetings in Washington D.C, USA..<br>Board Audit Committee held its 3rd Meeting<br>Manager Internal Audit attended the IMF Safeguards Assessments Training in Singapore<br>Bokolo Hornets (netball) first in top 4 knock outs Honiara Netball League<br>CM/HRCDS & LCO attended "from classroom to board room" training in PNG<br>Senior Analyst (Insurance) of Financial Markets Department attended the workshop for Association of Financial Supervisors of Pacific Countries in Apia, Samoa<br>Governor and Manager Financial Markets Department and Analyst (Banking Unit) attended BSP Supervisory College in Suva, Fiji<br>CBSI Board Audit Committee meeting and teleconference with IMF Safeguards assessment team.<br>Seventh CBSI Board meeting convened,  |
| November  | Governor met the PFTAC Evaluation Team<br>Eighth CBSI Board meeting convened,<br>Manager International and Senior Investment Officer attended STI-IMF course on Strategic Asset Management, Singapore<br>Two additional security officers recruited.<br>BOP sector meeting Financial Markets Department did an onsite examination of Solomon Islands National Provident Fund  |
| December  | Special CBSI Board Meeting convened.<br>CBSI Board Audit Committee held 4th Meeting.<br>Governor, Chief Manager Economic Research and Statistics and Manager Information Technology Department attended the 29th South Pacific Central Bank Governors' Annual Symposium in Suva.<br>Chief Manager Financial Markets Supervision participated in the onsite examination of Fiji National Provident Fund, Suva<br>Governor launched the Consultant's report on Government to Person (G2P) study.  |

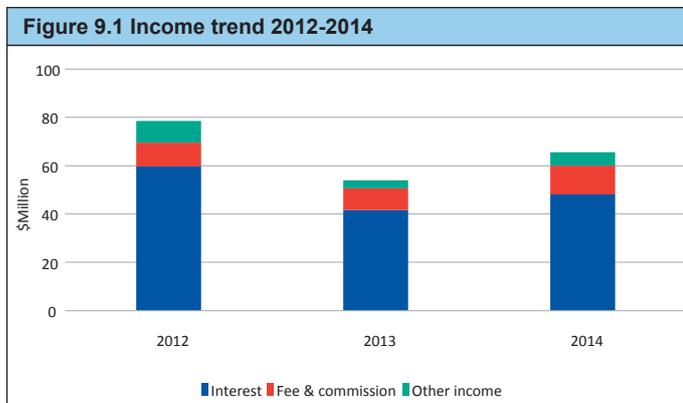
## CHAPTER 9: CBSI FINANCIAL ACCOUNTS 2014

### Financial Performance

The Banks financial performance improved during the year but remain under pressure from the effects of foreign exchange revaluation losses as a result of the appreciation of the Solomon Islands dollar against most of its trading partner currencies.

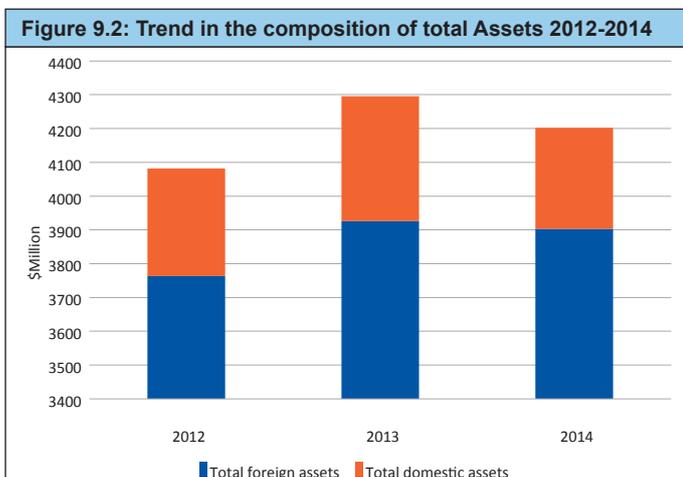
The main sources of income comprised of interest income from investment of foreign reserves, investment in government securities and from commissions on services rendered. In 2014 total income was \$65.6 million an increase from \$54 million in 2013.

The main expenditure for the Bank comprised of interest expenses on monetary policy borrowings, personnel, and other expenses which included items like depreciation.



Source: CBSI

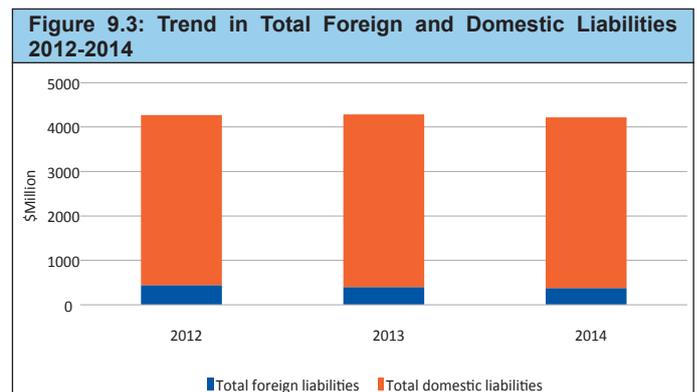
The Bank is required under the CBSI Act 2012 to adopt International Financial Reporting Standards (IFRS) to its financial reporting. IFRS requires that revaluation gains or losses in foreign exchange assets or financial assets for investment is accounted for in the Statement of Comprehensive Income. In 2014 the Bank incurred an unrealised foreign exchange losses of \$29 million compared to \$150 million losses in 2013. Accounting for the changes in revaluation of assets has impacted on the Banks net operat-



Source: CBSI

ing profit and in turn its capital and reserves in the past two years.

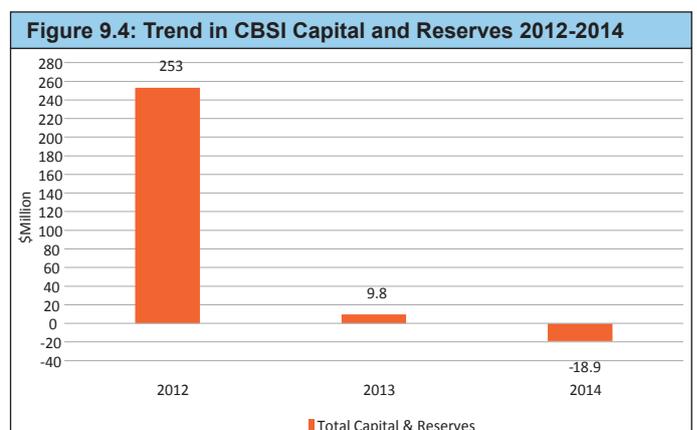
Figure 9.3 below shows the trend in CBSI's liabilities. The Bank's liabilities was made of deposits owed to foreign and domestic financial institutions and the Solomon Islands Government. Total liabilities also included the notes and coins circulated to the public during the year.



Source: CBSI

The volatility of the Solomon Islands dollar against foreign currencies making up the total international reserves resulted in exchange losses. As result, the Banks capital and reserves was negative.

As shown in Figure 9.4, the Bank used up all of its capital and reserves accumulated up to 2012 over the 2013 period and 2014 and needs recapitalization. How to correct the situation when the bank liabilities are more than its assets is provided for in Section 56 of the CBSI Act 2012 and the Board will activate this provision for the Government to inject new capital to the Bank after the 2014 financial accounts are audited.



Source: CBSI

Details of the financial performance and accounts of the CBSI for 2014 is attached in the audited financial statements.



CENTRAL BANK OF SOLOMON ISLANDS

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DIRECTORS' REPORT

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**SOLOMON ISLANDS OFFICE  
OF THE AUDITOR-GENERAL****Independent auditor's report to the Board of the  
Central Bank of Solomon Islands****Report on the Financial Statements**

I have in joint consultation with the Board of the Bank pursuant to Section 60(1) of the Central Bank of Solomon Islands Act 2012 contracted KPMG Fiji which is part of the KPMG International network to assist me to audit the accompanying financial statements of the Central Bank of Solomon Islands, which comprise the statement of financial position as at 31 December 2014, and the statement of comprehensive income, statement of changes in equity and cash flow statements for the year then ended, and Notes 1 to 27 comprising of a summary of significant accounting policies and information.

**Boards' and Management's Responsibility for the Financial Statements**

The Board and Management are responsible for the preparation of financial statements that give a true and fair view in accordance with the requirements of the Central Bank of Solomon Islands Act 2012 and International Financial Reporting Standards and for such internal control as the board and management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

My responsibility is to express an opinion on these financial statements based on my audit. The audit has been conducted in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor consider internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

**Basis of qualification***Currency in circulation*

As at 31 December 2014, currency in circulation is recorded in the financial statements at \$694.34m.

I was unable to obtain sufficient appropriate audit evidence regarding the completeness, existence and accuracy of this balance at year end as I could not satisfy myself as to the completeness, existence and accuracy of the currency in circulation balance as at 1 January 2014. I am unable to apply alternative audit procedures to verify the balance of currency in circulation as at 1 January 2014. Accordingly, I am not able to ascertain what adjustments, if any, might be necessary to the amounts recorded in the financial statements.

### Qualified opinion

In my opinion, except for the effect if any, of the matters referred to in the qualification paragraphs above, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2014 and of its financial performance, changes in equity and cash flows for the year then ended in accordance with International Financial Reporting Standards.

### Emphasis of matter

Without modifying my opinion, the Bank had a deficiency in net assets of \$18.8 million as at 31 December, 2014. The Bank's total assets of \$4.20 billion was less than the sum of the Bank's total monetary liabilities and its unimpaired capital of \$4.27 billion. These conditions have arisen from the Bank's large open position in foreign currency which is subject to foreign exchange rate movements.

Under section 56 of the Central Bank of Solomon Islands Act 2012, the Bank will be required to inform the Minister for Finance within 30 days of this report of the reasons for this shortfall and request a capital contribution to remedy the shortfall.

These conditions may cast doubt on the ability of the Bank to continue as a going concern except for the Bank's ability to access Solomon Island Government financial support should that become necessary.



**Robert Cohen**  
Acting Auditor-General

**Office of the Auditor-General**  
Honiara, Solomon Islands

30 April, 2015

## DIRECTOR'S REPORT

The Directors present their report together with the financial statements of the Central Bank of the Solomon Islands ("the Bank") for the year ended 31 December 2014 and the auditors' report thereon.

### Directors

The Directors in office during the financial year and at the date of this report were:

|                  |   |
|------------------|---|
| Denton Rarawa    | (Chairman and Governor)                       |
| Gane Simbe       | (Deputy Governor)                             |
| Shardrach Fanega | (retired from membership on 25 November 2014) |
| Fred Fakarii     | (appointed 25 November 2014)                  |
| Katululu Maepioh |   |
| Loyley Ngira     |   |
| Lily Lomulo      |   |
| Tele Bartlett    |   |
| PrimoAfeau       |   |
| John Usuramo     |   |

### State of affairs

In the opinion of the Directors:

- there were no significant changes in the state of affairs of the Bank during the financial year under review not otherwise disclosed in this report or the financial statements;
- the accompanying statement of financial position gives a true and fair view of the state of affairs of the Bank as at 31 December 2014 and the accompanying statement of profit and loss and other comprehensive income, statement of changes in equity and statement of cash flows give a true and fair view of the results of the Bank for the year then ended.

### Principal activities

The Bank's role as a central bank, as defined in the Central Bank of Solomon Islands Act, 2012 is:

- (a) to achieve and to maintain domestic price stability;
- (b) to foster and to maintain a stable financial system;
- (c) to support the general economic policies of the government.

### Trading results

The net loss of the Bank for the year ended 31 December 2014 was \$28.91m (2013: \$165.10m).

### Reserves

The Board approved the following transfers of reserves in the statement of profit and loss and other comprehensive income during the year:

- \$2.25m (2013: \$0.61 m) to the asset revaluation reserve;
- (\$28.86m) (2013: (\$150.55m)) to the foreign exchange assets revaluation reserve; and
- (\$2.30m) (2013: (\$15.17m)) to the general reserve.

### Provisions

There were no material movements in provisions during the year apart from the normal amounts set aside for such items as depreciation and employee entitlements.

### Assets

The Directors took reasonable steps before the Bank's financial statements were made out to ascertain that the assets of the Bank were shown in the accounting records at a value equal to or below the value that would be expected to be realised in the ordinary course of business.

At the date of this report, the Directors are not aware of any circumstances which would render the values attributable to the assets in the financial statements misleading.

### Directors' benefit

No director of the Bank has, since the last financial year, received or become entitled to receive a benefit (other than a benefit included in the total amount of emoluments received or due and receivable by directors shown in the Bank's financial statements) by reason of a contract made with the Bank or a related corporation with the director or with a firm of which he is a member, or in a Bank in which he has a substantial financial interest.

### Events subsequent to balance date

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Bank, to affect significantly the operations of the Bank, the results of those operations, or the state of affairs of the Bank, in future financial years.

### Other circumstances

At the date of this report, the Directors are not aware of any circumstances not otherwise dealt with in this report or financial statements which render amounts stated in the financial statements misleading.

Dated at Honiara this 29<sup>th</sup> of April 2015.

Signed in accordance with a resolution of the Board of Directors:



Acting Chairperson and Governor



Director



CENTRAL BANK OF SOLOMON ISLANDS

STATEMENT BY DIRECTORS

In the opinion of the Directors:

- (a) the accompanying statement of profit and loss and other comprehensive income is drawn up so as to give a true and fair view of the results of the Bank for the year ended 31 December 2014;
- (b) the accompanying statement of financial position is drawn up so as to give a true and fair view of the state of affairs of the Bank as at 31 December 2014;
- (c) the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the changes in equity of the Bank for the year ended 31 December 2014;
- (d) the accompanying statement of cash flows is drawn up so as to give a true and fair view of the cash flows of the Bank for the year ended 31 December 2014;
- (e) at the date of this statement there are reasonable grounds to believe the Bank will be able to pay its debts as and when they fall due;
- (f) all related party transactions have been adequately recorded in the books of the Bank, and
- (g) the financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRS").

For and on behalf of the Board of Directors by authority of a resolution of the Directors this 29<sup>th</sup> of April, 2015.

Acting Chairperson and Governor

Director

**STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME  
FOR THE YEAR ENDED 31 DECEMBER 2014**

|  | Note | 2014<br>\$000   | 2013<br>\$000    |
|--|------|-----------------|------------------|
| <b>Income</b>  |      |                 |                  |
| Interest income  | 4(a) | 48,176          | 41,737           |
| Fees and commission income   | 4(b) | 11,896          | 8,958            |
| Other income   | 4(c) | 3,283           | 2,738            |
| Change in fair value of investment properties                      | 10   | 2,245           | 612              |
| Net unrealized foreign exchange revaluation gain                   |      | -               | -                |
| <b>Total income</b>  |      | <u>65,600</u>   | <u>54,045</u>    |
| <b>Expenses</b>  |      |                 |                  |
| Interest expense   | 4(d) | 9,864           | 7,149            |
| Fees and commission expense  |      | 1,126           | 1,047            |
| Administration expenses  | 4(e) | 33,202          | 32,579           |
| Other expenses   | 4(f) | 21,460          | 27,823           |
| Net unrealized foreign exchange revaluation loss                   |      | 28,860          | 150,548          |
| <b>Total expenses</b>  |      | <u>94,512</u>   | <u>219,146</u>   |
| <b>Net operating (loss)/profit</b>                                 |      | <u>(28,912)</u> | <u>(165,101)</u> |
| <b>Other comprehensive losses</b>                                  |      |                 |                  |
| Net change in fair value (available - for - sale financial assets) |      | 275             | (77,935)         |
| Net change in revaluation (property, plant and equipment)          |      | -               | -                |
| <b>Total other comprehensive (loss)/income</b>                     |      | <u>275</u>      | <u>(77,935)</u>  |
| <b>Total comprehensive (loss)/ income</b>                          |      | <u>(28,637)</u> | <u>(243,036)</u> |



Acting Chairperson and Governor



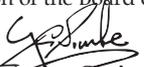
Director

*This statement of profit and loss and other comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 50 to 68.*

**STATEMENT OF FINANCIAL POSITION  
AS AT 31 DECEMBER 2014**

|   | Note  | 2014<br>\$000    | 2013<br>\$000    |
|---|-------|------------------|------------------|
| <b>Foreign currency assets</b>                            |       |                  |                  |
| Cash at bank  | 20    | 576,723          | 732,680          |
| Accrued interest  |       | 5,151            | 9,167            |
| Held-to-maturity investments                              | 5     | 2,884,550        | 2,753,823        |
| Available-for-sale investments                            | 6     | 221,368          | 213,073          |
| International Monetary Fund                               | 7     | 214,940          | 217,009          |
| <b>Total foreign currency assets</b>                      |       | <u>3,902,732</u> | <u>3,925,752</u> |
| <b>Local currency assets</b>                              |       |                  |                  |
| Cash on hand  | 20    | 224              | 300              |
| Loans and advances  | 8     | 75,299           | 81,278           |
| Currency inventory  | 9     | 32,347           | 39,859           |
| Investment properties                                     | 10    | 12,662           | 11,935           |
| Other assets  | 11    | 40,707           | 98,529           |
| Property, plant and equipment                             | 12    | 138,116          | 138,140          |
| <b>Total local currency assets</b>                        |       | <u>299,355</u>   | <u>370,041</u>   |
| <b>Total assets</b>                                       |       | <u>4,202,087</u> | <u>4,295,793</u> |
| <b>Foreign currency liabilities</b>                       |       |                  |                  |
| International Monetary Fund                               | 7     | 361,409          | 356,595          |
| Demand deposits   | 13(a) | 11,549           | 43,890           |
| <b>Total foreign currency liabilities</b>                 |       | <u>372,958</u>   | <u>400,485</u>   |
| <b>Local currency liabilities</b>                         |       |                  |                  |
| Demand deposits   | 13(b) | 2,481,652        | 2,601,955        |
| Currency in circulation                                   | 14    | 694,344          | 617,570          |
| Fixed deposits  | 15    | 621,729          | 611,932          |
| SIG monetary operations account                           | 16    | 30,215           | 33,604           |
| Employee entitlements                                     | 17    | 13,946           | 11,009           |
| Other liabilities   | 18    | 6,044            | 9,402            |
| <b>Total local liabilities</b>                            |       | <u>3,847,930</u> | <u>3,885,472</u> |
| <b>Total liabilities</b>                                  |       | <u>4,220,888</u> | <u>4,285,957</u> |
| <b>Net assets</b>   |       | <u>(18,801)</u>  | <u>9,836</u>     |
| <b>Capital and reserves</b>                               |       |                  |                  |
| Paid up capital   | 21    | 50,000           | 50,000           |
| General reserve   | 22(a) | 35,572           | 37,869           |
| Foreign exchange revaluation reserve                      | 22(b) | (174,432)        | (145,572)        |
| Asset revaluation reserve                                 | 22(c) | 89,092           | 86,847           |
| Gold revaluation reserve                                  | 22(d) | (80,908)         | (81,183)         |
| Capital asset reserve                                     | 22(e) | 61,875           | 61,875           |
| <b>Total (deficiency)/surplus in capital and reserves</b> |       | <u>(18,801)</u>  | <u>9,836</u>     |

Signed in accordance with the resolution of the Board of Directors:

  
Gane Simbe - Acting Chairperson and Governor

  
Fred Fakari'i - Director

*This statement of profit and loss and other comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 50 to 68.*

## STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2014

|   | Issued & paid up capital | Gold revaluation reserve | General reserve | Foreign exchange assets revaluation reserve | Asset revaluation reserve | Capital assets reserve | Total           |
|---|--------------------------|--------------------------|-----------------|---|---------------------------|------------------------|-----------------|
|   | \$000                    | \$000                    | \$000           | \$000                                       | \$000                     | \$000                  | \$000           |
| Balance as at 1 January 2013                                | 20,000                   | (3,248)                  | 83,034          | 4,976                                       | 86,235                    | 61,875                 | 252,872         |
| <b>Total comprehensive income for the year</b>              |                          |                          |                 |   |                           |                        |                 |
| Profit (loss) for the year (Note 19)                        | -                        | -                        | (15,165)        | (150,548)                                   | 612                       | -                      | (165,101)       |
| <i>Other comprehensive income/(losses)</i>                  |                          |                          |                 |   |                           |                        |                 |
| Fair value gains – gold                                     | -                        | (77,935)                 | -               | -   | -                         | -                      | (77,935)        |
| <i>Total other comprehensive income/(losses)</i>            | -                        | (77,935)                 | (15,165)        | (150,548)                                   | 612                       | -                      | (243,036)       |
| <b>Total comprehensive income/(losses)</b>                  | <b>20,000</b>            | <b>(81,183)</b>          | <b>67,869</b>   | <b>(145,572)</b>                            | <b>86,847</b>             | <b>61,875</b>          | <b>9,836</b>    |
| <i>Transaction with owners, recorded directly in equity</i> | <b>30,000</b>            | -                        | <b>(30,000)</b> | -   | -                         | -                      | -               |
| <b>Balance as at 31 December 2013</b>                       | <b>50,000</b>            | <b>(81,183)</b>          | <b>37,869</b>   | <b>(145,572)</b>                            | <b>86,847</b>             | <b>61,875</b>          | <b>9,836</b>    |
| <b>Balance at 1 January 2014</b>                            | <b>50,000</b>            | <b>(81,183)</b>          | <b>37,869</b>   | <b>(145,572)</b>                            | <b>86,847</b>             | <b>61,875</b>          | <b>9,836</b>    |
| <b>Total comprehensive income for the year</b>              |                          |                          |                 |   |                           |                        |                 |
| Profit (loss) for the year (Note 19)                        | -                        | -                        | (2,297)         | (28,860)                                    | 2,245                     | -                      | (28,912)        |
| <i>Other comprehensive income/(losses)</i>                  |                          |                          |                 |   |                           |                        |                 |
| Fair value losses – gold                                    | -                        | 275                      | -               | -   | -                         | -                      | 275             |
| <b>Total comprehensive income/(losses)</b>                  | <b>-</b>                 | <b>275</b>               | <b>(2,297)</b>  | <b>(28,860)</b>                             | <b>2,245</b>              | <b>-</b>               | <b>(28,637)</b> |
| <b>Balance as at 31 December 2014</b>                       | <b>50,000</b>            | <b>(80,908)</b>          | <b>35,572</b>   | <b>(174,432)</b>                            | <b>89,092</b>             | <b>61,875</b>          | <b>(18,801)</b> |

This statement of profit and loss and other comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 50 to 68.

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2014

|   | Note      | 2014<br>\$000   | 2013<br>\$000    |
|---|-----------|-----------------|------------------|
| <b>Operating activities</b>                                       |           |                 |                  |
| Interest received   |           | 49,760          | 42,160           |
| Other income  |           | 15,098          | 11,515           |
| Interest paid   |           | (8,057)         | (2,625)          |
| Cash paid to suppliers and employees                              |           | (43,345)        | (54,791)         |
| Net movement in held to maturity investments                      |           | (128,293)       | (198,719)        |
| Net movement in International Monetary Fund accounts              |           | 10,121          | 3                |
| Net movement in other receivables                                 |           | 61,548          | (52,335)         |
| Net movement in other payables                                    |           | (3,359)         | 7,497            |
| <b>Cash flows used in operating activities</b>                    |           | <b>(46,527)</b> | <b>(247,295)</b> |
| <b>Investing activities</b>                                       |           |                 |                  |
| Acquisition of property, plant and equipment                      |           | (4,179)         | (10,720)         |
| Proceeds from sale of premises, plant and equipment               |           | 81              | 181              |
| Net movement in available-for-sale investments                    |           | (8,021)         | (74,096)         |
| Net movement in loan to government                                |           | 5,894           | 7,214            |
| Net movement in loans and advances to staff                       |           | 85              | (1,318)          |
| <b>Cash flows used in investing activities</b>                    |           | <b>(6,140)</b>  | <b>(78,739)</b>  |
| <b>Financing activities</b>                                       |           |                 |                  |
| Net movement in currency in circulation                           |           | 76,774          | 10,634           |
| Net movement in demand deposits                                   |           | (154,450)       | 36,406           |
| Net movement in fixed deposits received                           |           | 9,797           | 400,613          |
| Solomon Islands government monetary operations                    |           | (3,390)         | (4,782)          |
| Net movement in International Monetary Fund credit facilities     |           | (3,237)         | 1,786            |
| <b>Cash flows (used in)/from financing activities</b>             |           | <b>(74,506)</b> | <b>444,657</b>   |
| <b>Net effect of exchange rates</b>                               |           | <b>(28,860)</b> | <b>(150,548)</b> |
| Net decrease in cash  |           | (156,033)       | (31,925)         |
| Cash and cash equivalents at the beginning of the financial year  |           | 732,980         | 764,904          |
| <b>Cash and cash equivalents at the end of the financial year</b> | <b>20</b> | <b>576,947</b>  | <b>732,980</b>   |

*This statement of profit and loss and other comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 50 to 68.*

### NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

#### 1. Principal activities and principal place of operations

The Central Bank of Solomon Islands ("the Bank") operates under the Central Bank of Solomon Islands Act, 2012. The Bank is an independent legal entity wholly owned by, and reporting to, the Government of the Solomon Islands. The Bank's primary objective as defined in the Central Bank of Solomon Islands Act, 2012, Section 8 is:

- (a) to achieve and to maintain domestic price stability;
- (b) to foster and to maintain a stable financial system;
- (c) to support the general economic policies of the government.

The Bank's principal place of operations is located at Mud Alley Street, Honiara, Solomon Islands.

The financial statements were authorised for issue by the Board of Directors on 29<sup>th</sup> April 2015.

#### 2. Basis of preparation

##### (a) Statement of compliance

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ('IFRS') and the Central Bank of Solomon Islands Act, 2012, except where the Central Bank of Solomon Islands Act, 2012 requires different treatment in which case the Central Bank of Solomon Islands Act, 2012 takes precedence.

The Bank has not complied with the requirements of the Central Bank of Solomon Islands Act 2012 (Section 56) which requires that in the event that the value of its assets falls below the sum of its monetary liabilities and its unimpaired authorised capital

- (a) The Board, with the advice of the external auditor of the Central Bank, shall assess the situation and prepare a report on the causes and extent of the shortfall and assess the situation within a period of no more than 30 calendar days;
- (b) If the Board approves the report under paragraph (a), the Central Bank shall request the Minister for Finance for a capital contribution to be made by the Government to remedy the deficit; and
- (c) Upon receipt of this request the Government shall, within a period of no more than 30 calendar days, transfer to the Central Bank the necessary amount in currency or in negotiable debt instruments with a specified maturity issued at market-related interest rates prevailing in Solomon Islands.

As at 31 December 2014, the Bank's total assets amounted to \$4.20 billion (2013:\$4.30 billion). This was less than the sum of the Bank's total monetary liabilities and its unimpaired capital which totalled \$4.27 billion (2013:\$4.34 billion).

##### (b) Going concern basis of accounting

The financial statements have been prepared on a going concern basis notwithstanding that at 31 December 2014 the Bank had a deficiency in net assets of \$18.8m.

The Bank's continuation as a going concern is dependent upon the continued support of the Solomon Islands Government. These conditions indicate the existence of a material uncertainty which may cast doubt on the Bank's ability to continue as a going concern.

The Directors consider it appropriate to prepare these financial statements on a going concern basis as the Bank under Section 56 of the Central Bank of Solomon Islands Act 2012 is required to request the Minister of Finance for a capital contribution to be made by the Government to remedy the deficit.

The financial statements do not include any adjustments relating to the recoverability or classification of recorded asset amounts and classification of liabilities that might be necessary should the Bank be unable to continue as a going concern

##### (c) Basis of measurement

The financial statements have been prepared on the historical cost basis and do not take into account changes in money values except for the following material items in the statement of financial position.

- Available-for-sale financial assets are measured at fair value.
- Held to maturity financial assets are measured at amortised cost.
- Land and buildings classified as property, plant and equipment are measured at fair value.
- Investment properties are measured at fair value.

##### (d) Functional and presentation currency

The financial statements are presented in Solomon Islands dollars, which is the Bank's functional currency. All financial information presented in Solomon Islands dollars has been rounded to the nearest thousand except when otherwise indicated.

##### (e) Use of estimates and judgement

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revision to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amount of assets and liabilities within the next financial year are discussed in the following paragraphs;

### *Impairment of financial assets*

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Bank on terms that the Bank would not consider otherwise, indications that a debtor or issuer will enter into bankruptcy, adverse changes in the payment status of borrowers or issuers in the Bank, economic conditions that correlate with defaults or the disappearance of an active market for a security.

### 3. Statement of significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in the financial statements.

#### (a) Foreign currency

Transactions in foreign currencies are translated into the functional currency of the Bank at the spot exchange rates at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the spot exchange rate at the end of the year.

Non-monetary items that are measured based on historical cost in a foreign currency are translated using the spot exchange rate at the date of transaction.

Foreign currency differences arising on retranslation are recognised in profit or loss.

#### (b) Interest

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes all transaction costs and fees paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Interest income and expense presented in the statement of profit and loss and other comprehensive income include:

- Interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis; and
- Interest on available-for-sale investments securities calculated on an effective interest basis.

#### (c) Fees and commission

Fees and commission income and expense relate mainly to transaction and service fees, which are expensed as the services are received.

#### (d) Other income

Other income are brought to account on an accrual basis

#### (e) Tax expense

The Bank is exempted from income tax under the Income Tax (Central Bank of Solomon Islands) (Exemption) Order of 21 June 1976 as provided for under Section 16 (2) of the Income Tax Act (CAP 123).

#### (f) Financial assets and financial liabilities

##### i. Recognition

The Bank initially recognises loans and advances, deposits and debt securities on the date that they are originated. All other financial assets and liabilities are recognised initially on the trade date, which is the date that the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

##### ii. Classification

###### Financial assets

The Bank classifies its financial assets in one of the following categories:

- loans and advances;
- held to maturity;
- available-for-sale. Financial liabilities

The Bank classifies its financial liabilities as measured at amortised cost.

### NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

#### iii. Derecognition

##### Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in such transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

##### Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

#### iv. Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

#### v. Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

The Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and present actual and regularly occurring market transactions on an arm's length basis.

Assets are measured at a bid price, while liabilities are measured at an asking price. Fair values reflect the credit risk of the instrument and include adjustments to take account of credit risk of the Bank.

##### (g) Cash and cash equivalents

Cash and cash equivalents include notes and coins held by the Bank, teller's cash, current accounts with a maturity of three months or less from the acquisition date and other short term highly liquid term deposits.

Cash and cash equivalents are carried at amortised costs in the statement of financial position.

##### (h) Held-to-maturity

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity. Held-to-maturity investments comprise of fixed term deposits, short term commercial papers and bonds.

Held-to-maturity investments are carried at amortised costs using the effective interest method less any impairment losses. A sale or reclassification of more than an insignificant amount of held-to maturity investments would result in the reclassification of all held-to-maturity investments as available for sale, and would prevent the Bank from classifying investment securities as held to maturity for the current and the following two financial years.

##### (i) Available-for-sale

Available-for-sale investments are non-derivative investments that are designated as available-for sale or are not classified as another category of financial assets. Available-for-sale investments comprise of gold holdings and are carried at fair value.

Fair value changes other than impairment losses are recognised in other comprehensive income and presented in the gold revaluation reserve in equity. When the investment is sold, the gain or loss accumulated in equity is reclassified to profit or loss. Impairment losses are recognised in profit or loss.

##### (j) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term. Loans and advances comprises of loans and advances to the Solomon Islands Government and staff loans.

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

##### (k) Currency Inventory

Currency inventory are recognised in the statement of financial position at cost.

Currency inventory relates to notes and coins purchased for circulation. The amount expensed in profit or loss is based on the cost of notes and coins that are issued into circulation.

##### (l) Currency in circulation

Currency issued by the Bank represents a claim on the Bank in favour of the holder. Currency in circulation comprises notes and coins issued by the Bank and the liability for currency in circulation is recorded at face value in the statement of financial position.

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

### (m) Property, plant and equipment

#### Recognition and measurement

Certain items of property, plant and equipment are initially measured at cost less accumulated depreciation and any accumulated impairment losses. Land and buildings are initially recognised at cost less accumulated depreciation and subsequently revalued to fair value.

Cost includes expenditure that is directly attributable to the acquisition of the asset. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

Any gain or loss on disposal of property, plant and equipment (calculated as the difference between the net proceeds from disposal and the carrying amount of the asset at the time of disposal) is recognised within other income in profit or loss.

#### Subsequent costs

Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Bank. Ongoing repairs and maintenance are expensed as incurred.

#### Depreciation

Items of property, plant and equipment are depreciated from the date they are available for use. Depreciation is charged on a straight line basis over the estimated useful lives of the assets. The rates of depreciation used are based on the following estimated useful lives:

|                                |             |
|--------------------------------|-------------|
| Buildings                      | 4- 55 years |
| Computers                      | 3 years     |
| Furniture, plant and equipment | 3- 5 years  |
| Motor vehicles                 | 4 years     |

#### Periodic revaluation

The Board has determined that apart from land and buildings, the remaining fixed assets of the Bank are recorded at values approximating recoverable market values. With Board approval, a three year periodical revaluation of its land and buildings was firstly done in 2006 and recently done in 2012. This included a review of the asset classes, estimated useful lives and depreciation rates, and current market values where deemed appropriate. The basis of this valuation is the open market value, that is, the highest and best value the property would expect to be realised if put for sale by private treaty. The Board proposes to have such assets revalued every three years.

### (n) Investment property

Investment property, is property held either to earn rentals or for capital appreciation or for both. Investment property is initially measured at cost and subsequently at fair value with any change therein recognised in profit or loss. Costs include expenditures that are directly attributable to the acquisition of the investment property.

Any gain or loss on disposal of an investment property (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in profit or loss. When an investment property that was previously classified as property, plant and equipment is sold, any related amount included in the revaluation reserve is transferred to retained earnings.

When the use of the property changes such that it is reclassified as property, plant and equipment, its fair value at the date of the reclassification becomes its cost for subsequent accounting.

### (o) Demand deposits

Demand deposits represent funds placed with the Bank by financial institutions and other organisations. Demand deposits are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. These deposits are at call.

### (p) Employee entitlements

#### Short-term employee benefits

Short-term employee benefits comprising of accrued wages and salaries, annual leave and entitlement to Solomon Islands National Provident Fund are measured on an undiscounted basis and are expensed as the related service is provided.

Liabilities recognised in respect of short-term employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

#### Long-term employee benefits

Long-term employee benefits comprises of long service leave and early retirement benefit. Liabilities recognised in respect of long-term employee benefits which are not expected to be settled within 12 months are measured at the present value of the estimated future cash outflows to be made resulting from employee's service provided to balance date, based on staff turnover history and is discounted using the rates attaching to the external bonds portfolio.

### (p) Impairment

The carrying amounts of the Bank's assets are reviewed at balance date to determine whether there is any indication of impairment. If any such indication exists, the assets recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss.

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014**

**(r) Comparative figures**

Where necessary, comparative figures have been changed to conform to changes in presentation in the current year.

**(s) New standards and interpretations not yet adopted**

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2014, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Bank, except for IFRS Financial Instruments, which becomes mandatory for the Bank's 2018 financial statements and could change the classification and measurement of financial assets. The Bank does not plan to adopt this standard early and the extent of the impact has not been determined.

|                                       | 2014          | 2013          |
|---------------------------------------|---------------|---------------|
|                                       | \$000         | \$000         |
| <b>4. Income and expenses</b>         |               |               |
| <b>(a) Interest income</b>            |               |               |
| Overseas investments                  | 46,482        | 39,913        |
| Local investments                     | 1,694         | 1,824         |
|                                       | <u>48,176</u> | <u>41,737</u> |
| <b>(b) Fees and commission income</b> |               |               |
| Foreign currency dealings             | 8,958         | 7,784         |
| Local dealings                        | 2,938         | 1,174         |
|                                       | <u>11,896</u> | <u>8,958</u>  |
| <b>(c) Other income</b>               |               |               |
| Gain on disposal of fixed assets      | 81            | 181           |
| Rent received                         | 870           | 934           |
| Sale of numismatic coins              | 223           | 139           |
| Gains on foreign currency exchange    | 114           | 614           |
| Royalties on numismatics              | 1,261         | 649           |
| Others                                | 734           | 221           |
|                                       | <u>3,283</u>  | <u>2,738</u>  |
| <b>(d) Interest expense</b>           |               |               |
| Foreign liabilities                   | 106           | 82            |
| Local liabilities                     | 9,758         | 7,067         |
|                                       | <u>9,864</u>  | <u>7,149</u>  |
| <b>(e) Administrative expenses</b>    |               |               |
| Staff costs                           | 24,162        | 23,306        |
| Telecommunication                     | 2,291         | 1,783         |
| Utilities                             | 2,340         | 2,442         |
| Repairs and maintenance               | 1,837         | 2,217         |
| Insurance                             | 610           | 345           |
| Consumables                           | 307           | 834           |
| Stationery, printing and postage      | 918           | 710           |
| Consultancy                           | 127           | 39            |
| Other                                 | 610           | 903           |
|                                       | <u>33,202</u> | <u>32,579</u> |

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

|   | 2014<br>\$000    | 2013<br>\$000    |
|---|------------------|------------------|
| <b>(f) Other expenses</b>                     |                  |                  |
| Board of directors remunerations and expenses | 190              | 529              |
| Currency expenses                             | 13,551           | 17,913           |
| Depreciation                                  | 5,721            | 7,255            |
| Auditors remuneration                         | 386              | 309              |
| Loss on realisation of gold instrument        | -                | 590              |
| Other   | 1,612            | 1,227            |
|   | <u>21,460</u>    | <u>27,823</u>    |
| <b>5. Held-to-maturity investments</b>        |                  |                  |
| Fixed term deposits                           | 2,629,234        | 2,454,535        |
| Short term commercial paper                   | 124,081          | 128,914          |
| Bonds   | 131,235          | 170,374          |
|   | <u>2,884,550</u> | <u>2,753,823</u> |
| <b>6 Available-for-sale investments</b>       |                  |                  |
| Unallocated gold - at fair value              | 107,302          | 103,281          |
| Gold bullion - at fair value                  | 114,066          | 109,792          |
|   | <u>221,368</u>   | <u>213,073</u>   |

## 7. International Monetary Fund

The Solomon Islands is a member of the International Monetary Fund (IMF) and the Central Bank of Solomon Islands has been designated as the Government of Solomon Island's fiscal agency (through which the Government deals with the IMF) and as the depository for the IMF's holding in Solomon Islands dollars.

The Solomon Islands subscription to the IMF has been met by:

- (i) payment to the IMF out of the Central Bank's external assets which have been reimbursed by the Government of Solomon Islands by issue of non-interest bearing securities;
- (ii) the funding of accounts in favor of the IMF in the books of the Central Bank by the Government of Solomon Islands.
- (iii) The liabilities to the IMF include subscriptions which are maintained in the IMF No.1 and IMF No. 2 accounts, are disclosed together as capital subscription. The IMF maintains such balances in their accounts in both Special Drawing Rights (SDR) and Solomon Islands dollar equivalents; the Bank balances are maintained only in Solomon Islands dollars.

The standby credit facility with IMF commenced in 2010 with first disbursement received 23 June 2010. The final disbursement was transacted on the 1 December 2011.

The extended credit facility with IMF was approved and drawn down on 11 December 2012.

|                                | 2014<br>\$000  | 2013<br>\$000  |
|--------------------------------|----------------|----------------|
| <b>Foreign currency assets</b> |                |                |
| Reserve tranche position       | 6,253          | 6,029          |
| Special drawing rights         | 96,724         | 103,031        |
| Currency subscription          | 111,963        | 107,949        |
|                                | <u>214,940</u> | <u>217,009</u> |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

|   | 2014<br>\$000  | 2013<br>\$000  |
|---|----------------|----------------|
| <b>Foreign currency liabilities</b>                   |                |                |
| Standby credit facility                               | 130,038        | 136,774        |
| Special drawing rights allocation                     | 112,627        | 108,590        |
| Extended credit facility                              | 6,755          | 3,257          |
| Securities  | 107,059        | 107,059        |
| Capital subscription                                  | 4,930          | 915            |
|   | <u>361,409</u> | <u>356,595</u> |
| <b>8. Loans and advances</b>                          |                |                |
| <i>Solomon Islands Government</i>                     |                |                |
| Loans and advances                                    | 46             | 46             |
| Development bonds                                     | 27             | 27             |
| Treasury bills  | 10             | 483            |
| Other securities                                      | 4,936          | 4,936          |
| Amortising bonds                                      | 63,970         | 63,391         |
|   | <u>68,989</u>  | <u>74,883</u>  |
| <i>Staff loans</i>                                    |                |                |
| Staff housing loans                                   | 4,729          | 4,947          |
| Management car loans                                  | 424            | 391            |
| Personal loans  | 1,157          | 1,057          |
|   | <u>6,310</u>   | <u>6,395</u>   |
|   | <u>75,299</u>  | <u>81,278</u>  |
| <b>9. Currency inventory</b>                          |                |                |
| Notes   | 10,759         | 20,406         |
| Coins   | 21,588         | 19,453         |
|   | <u>32,347</u>  | <u>39,859</u>  |
| <b>10. Investment properties</b>                      |                |                |
| Balance at beginning of financial year- at fair value | 11,935         | 11,323         |
| Less: transferred to PPE                              | (1,518)        | -              |
| Changes in fair value                                 | 2,245          | 612            |
| Balance at end of financial year- at fair value       | <u>12,662</u>  | <u>11,935</u>  |

Investment property comprises of a commercial and a residential property that are leased to third parties. Each lease contains a lease period of 3 and 2 years respectively with annual rental subject to increase upon renewal of Honiara retail price index. Subsequent renewals are negotiated with the lessee.

When rent reviews or lease renewals have been pending with anticipated reversionary increases, all notices, when appropriate counter-notices, have been served validly and within the appropriate time.

Rental income from investment properties of \$870,000 (2013: \$934,000) has been recognised in other income.

*Fair value hierarchy*

The fair value of investment property was determined by an external, independent property valuer, having appropriate recognised professional qualifications and recent experience in the location and category of the property being valued. The independent valuer provide the fair value of the Bank's investment property portfolio every 12 months.

The fair value of the Bank's investment property are categorised into Level 3 of the fair value hierarchy.

*Valuation techniques and significant unobservable inputs*

The following table shows the valuation technique used in measuring the fair value of investment properties, as well as significant unobservables inputs used.

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

| Valuation technique  | Significant unobservable inputs  | Inter-relationship between key unobservable inputs and fair value measurement  |
|--|--|--|
| Replacement cost method:<br>where the improvements are valued using current replacement cost and an allowance for depreciation and obsolescence plus the freehold value of the land (notable sales of comparable vacant sites within Honiara are noted). | <ul style="list-style-type: none"> <li>• Depreciation rate applied.</li> <li>• Locality of the property</li> <li>• Proximity to civic amenities</li> <li>• Topography/geographical feature of the land</li> <li>• Demand for the land</li> </ul> | The estimated fair value would increase (decrease if: <ul style="list-style-type: none"> <li>• depreciation rate were lower (higher);</li> <li>• the property located in urban locality;</li> <li>• closer to civic amenities;</li> <li>• the higher the demand for the land.</li> </ul> |

|              |       |
|--------------|-------|
| <b>2014</b>  | 2013  |
| <b>\$000</b> | \$000 |

### 11. Other assets

|                          |               |               |
|--------------------------|---------------|---------------|
| Commercial bank clearing | 36,930        | 97,905        |
| Others                   | 3,777         | 624           |
|                          | <b>40,707</b> | <b>98,529</b> |

### 12. Property, plant and equipment

|                                   | Land & buildings<br>\$000 | Plant, equipment & furniture<br>\$000 | Motor vehicles<br>\$000 | Computers<br>\$000 | Work in progress<br>\$000 | Total<br>\$000 |
|-----------------------------------|---------------------------|---------------------------------------|-------------------------|--------------------|---------------------------|----------------|
| <i>Cost/valuation</i>             |                           |                                       |                         |                    |                           |                |
| Balance at 1 January 2013         | 123,302                   | 22,565                                | 2,156                   | 5,406              | 3,108                     | 156,537        |
| Acquisitions                      | -                         | 2,050                                 | 437                     | 997                | 7,236                     | 10,720         |
| Transfers                         | 5,932                     | -                                     |                         |                    | (5,932)                   |                |
| Disposals                         |                           | (13)                                  | (351)                   | -                  | -                         | (364)          |
| Balance at 31 December 2013       | 129,234                   | 24,602                                | 2,242                   | 6,403              | 4,412                     | 166,893        |
| Transfer from Investment property | 1,518                     | -                                     | -                       | -                  | -                         | 1,518          |
| Acquisitions                      | -                         | 535                                   | 300                     | 738                | 2,606                     | 4,179          |
| Transfers                         | 4,522                     | 195                                   | -                       | -                  | (4,717)                   |                |
| Disposals                         | -                         | (7)                                   | (351)                   | (75)               | -                         | (433)          |
| Balance at 31 December 2014       | 135,274                   | 25,325                                | 2,191                   | 7,066              | 2,301                     | 172,157        |
| <i>Accumulated depreciation</i>   |                           |                                       |                         |                    |                           |                |
| Balance at 1 January 2013         | -                         | 16,810                                | 1,288                   | 3,764              |                           | 21,862         |
| Depreciation charge for the year  | 3,288                     | 2,288                                 | 473                     | 1,206              | -                         | 7,255          |
| Disposals                         | -                         | (13)                                  | (351)                   | -                  | -                         | (364)          |
| Balance at 31 December 2013       | 3,288                     | 19,085                                | 1,410                   | 4,970              | -                         | 28,753         |
| Depreciation charge for the year  | 2,751                     | 1,505                                 | 465                     | 1,000              |                           | 5,721          |
| Disposals                         | -                         | (7)                                   | (351)                   | (75)               |                           | (433)          |
| Balance at 31 December 2014       | 6,039                     | 20,583                                | 1,524                   | 5,895              |                           | 34,041         |
| <i>Carrying amount</i>            |                           |                                       |                         |                    |                           |                |
| At 1 January 2013                 | 123,302                   | 5,755                                 | 868                     | 1,642              | 3,108                     | 134,675        |
| At 31 December 2013               | 125,946                   | 5,517                                 | 832                     | 1,433              | 4,412                     | 138,140        |
| At 31 December 2014               | 129,235                   | 4,742                                 | 667                     | 1,171              | 2,301                     | 138,116        |

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014**

|  | 2014<br>\$000   | 2013<br>\$000    |
|--|---|------------------|
| <b>13. Demand deposits</b>   |   |                  |
| (a) Foreign currency demand deposits   |   |                  |
| Demand deposits  | <u>11,549</u>   | <u>43,890</u>    |
| Demand deposits include deposits from international organisations such as the Asian Development Bank (ADB), European Development Bank (EDB), International Fund for Agricultural Development (IFAD) and International Development Association. |   |                  |
|  | 2014<br>\$000   | 2013<br>\$000    |
| <b>(b) Local currency demand deposits</b>  |   |                  |
| Commercial banks   | 1,164,859   | 1,423,680        |
| Solomon Islands Government   | 1,305,694   | 1,161,336        |
| Other financial corporations   | 4,121   | 10,664           |
| Other  | <u>6,978</u>  | <u>6,275</u>     |
|  | <u>2,481,652</u>  | <u>2,601,955</u> |
| <b>14. Currency in circulation</b>   |   |                  |
| Notes  | 669,299   | 596,429          |
| Coins  | <u>25,045</u>   | <u>21,141</u>    |
|  | <u>694,344</u>  | <u>617,570</u>   |
| <b>15. Fixed deposits</b>  |   |                  |
| Bokolo bills   | <u>621,729</u>  | <u>611,932</u>   |
| Bokolo bills are short term discount securities issued and backed by the Central Bank of Solomon Islands. The instrument is used by the Bank for its monetary operations.  |   |                  |
|  | 2014<br>\$000   | 2013<br>\$000    |
| <b>16. SIG monetary operations account</b>   |   |                  |
| SIG monetary operations account  | <u>30,215</u>   | <u>33,604</u>    |
| <b>17. Employee entitlements</b>   |   |                  |
| Gratuity   | 1,107   | 329              |
| Long service leave   | 376   | 508              |
| Early retirement benefit   | <u>12,463</u>   | <u>10,172</u>    |
|  | <u>13,946</u>   | <u>11,009</u>    |
| <b>18. Other liabilities</b>   |   |                  |
| Unpresented bank cheques   | 3,845   | 7,149            |
| Other liabilities  | <u>2,199</u>  | <u>2,253</u>     |
|  | <u>6,044</u>  | <u>9,402</u>     |
| <b>19. Determination of distributable profit</b>   |   |                  |
| Profits of the Bank are determined and dealt with in accordance with Section 54 and 55 of the Central Bank of Solomon Islands Act., 2012 as follows:   |   |                  |
| a)   | Section 54(2)(a) states that unrealised revaluation gains shall be deducted from the net profits and shall not be available to be distributed but allocated to the respective unrealised revaluation reserve account; |                  |
| b)   | The realised gains from previous years shall be deducted from the appropriate revaluation reserve account and added to the distributable earnings as determined in section 54(2)(a).                                  |                  |

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

|   | 2014           | 2013            |
|---|----------------|-----------------|
|   | \$000          | \$000           |
| <i>Net profit distribution according to CBSI Act 2012</i> |                |                 |
| Net operating loss  | (28,912)       | (165,101)       |
| Add/ (less) net unrealised foreign exchange loss/ (gain)  | 28,860         | 150,548         |
| (Less) changes in fair value in investment properties     | (2,245)        | (612)           |
| Net (loss)/ gain to be recorded in general reserve        | <u>(2,297)</u> | <u>(15,165)</u> |

Section 55(3) of the Central Bank of Solomon Islands Act, 2012 states that negative distributable earnings shall first be charged to the general reserve account and subsequently applied to authorised capital.

|  | 2014  | 2013  |
|--|-------|-------|
|  | \$000 | \$000 |

### 20. Cash and cash equivalents

Cash and cash equivalents included in the statement of cash flows comprise of the following:

|   |                |                |
|---|----------------|----------------|
| Cash on hand - local currency               | 224            | 300            |
| Cash and cash equivalents- foreign currency | 576,723        | 732,680        |
|   | <u>576,947</u> | <u>732,980</u> |

### 21. Share capital

Section 6 (1) of the CBSI Act, states that the authorised and paid up capital of the bank shall be an amount equivalent to \$50 million dollars (2013: \$50 million). The capital is fully subscribed by the Government of Solomon Islands.

|  | 2014          | 2013          |
|--|---------------|---------------|
|  | \$000         | \$000         |
| Balance at the beginning of the year                                       | 50,000        | 20,000        |
| Transfer from General Reserve according to Section 6(1) of CBSI Act., 2012 |               | 30,000        |
| Balance at the end of the year   | <u>50,000</u> | <u>50,000</u> |

### 22. Reserves

Under Section 53(2) of the CBSI Act., 2012, the Bank shall maintain the following reserves. Their purpose and method of operation are to be as follows:

- (a) *General reserve*  
The general reserve was established under Section 53(1) as a reserve for the purposes of covering losses sustained by the Bank.
- (b) *Foreign exchange asset revaluation reserve*  
Unrealised gains and losses on revaluation of foreign exchange balances are recognised in the profit and loss under other comprehensive income and are transferred to the foreign exchange asset revaluation reserve at the end of the accounting period.
- (c) *Asset revaluation reserve*  
The asset revaluation reserve reflects the impact of changes in the market value of property.
- (d) *Gold revaluation reserve*  
The unallocated and allocated gold is valued at current quoted market prices. Gold is accounted for as an available for sale financial asset. Unrealised gains and losses arising from revaluation are recognised in the gold revaluation reserve at the end of the accounting period.
- (e) *Capital asset reserve*  
The capital asset reserve is used to strengthen the Bank's equity position in relation to future major capital investment in buildings and equipment.

### 23. Financial risk and management policies

#### (a) Introduction and overview

The structure of the Bank's statement of financial position is primarily determined by the nature of its statutory functions. International Financial Reporting Standards (IFRS) 7 - (Financial Instrument Disclosures) requires disclosure of information relating to financial instruments, their significance, performance, accounting policy, terms and conditions, fair values and the bank's policies for controlling risks and exposures relating to the financial instruments.

The Bank's risk management framework differs from the risk management framework for most other financial institutions. The main financial risks that the Bank faces include;

- Liquidity risk
- Credit risk
- Market risk
- Operational risk

### NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

This note presents information about the Bank's exposure to each of the above risks, the Bank's objectives, policies and procedures for measuring and managing risk.

#### *Risk management framework*

Like most central banks, the nature of the Bank's operations creates exposures to a range of operational and reputational risks. The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework.

The Bank's management seeks to ensure that strong and effective risk management and control systems are in place for assessing, monitoring and managing risk exposure. The Board of Directors and management are responsible for managing and monitoring the business strategy, risks and performance of the Bank.

Internal Audit forms part of the Bank's risk management framework. This function reports to the Governor and the Board Audit Committee on internal audit and related issues. All areas in the Bank are subject to periodic internal audit review.

The Bank is subject to an annual audit by an external auditor. Auditing arrangements are overseen by an Audit Committee of the Board to monitor the financial reporting and audit functions within the Bank and the committee reviews the internal audit functions as well. The committee reports to the Board of Directors on its activities.

The overall risk management framework is designed to strongly encourage the sound and prudent management of the Bank's risk. The Bank seeks to ensure the risk management framework is consistent with financial market best practice.

The risk tables in this note are based on the Bank portfolio as reported in its statement of financial position.

#### **(b) Liquidity risk**

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

#### *Management of liquidity risk*

To limit the liquidity risk, the Bank maintains an adequate level of reserves and taking into consideration the transaction demand on foreign exchange, ensures that an acceptable amount is maintained in current accounts at all times. The Bank invests in high quality instruments, including commercial paper and debt issued by Governments and Supranationals, all of which are easily converted to cash (refer to maturity analysis on liquidity).

The Central Bank of Solomon Islands Act 2012 (Section 56) requires that in the event that the value of its assets falls below the sum of its monetary liabilities and its unimpaired authorised capital, then-

- (a) The Board, with the advice of the external auditor of the Bank, shall assess the situation and prepare a report on the causes and extent of the shortfall and assess the situation within a period of no more than 30 calendar days;
- (b) If the Board approves the report under paragraph (a), the Bank shall request the Minister of Finance for a capital contribution to be made by the Government to remedy the deficit; and
- (c) Upon receipt of this request the Government shall, within a period of no more than 30 calendar days, transfer to the Bank the necessary amount in currency or in negotiable debt instruments with a specified maturity issued at market-related interest rates prevailing in Solomon Islands.

As at 31 December 2014, the Bank's total assets amounted to \$4.20 billion. This was less than the sum of the Bank's total monetary liabilities and its unimpaired capital which totalled \$4.27 billion.

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

Maturity analysis as at 31 December 2014

The maturity analysis noted below includes all financial assets and liabilities as at 31 December 2014.

|  | On<br>Demand<br>\$000 | 0-3<br>Months<br>\$000 | 3-6<br>Months<br>\$000 | 6-12<br>Months<br>\$000 | Over<br>Year<br>\$000 | Undefined<br>\$000 | Total<br>\$000 |
|--|-----------------------|------------------------|------------------------|-------------------------|-----------------------|--------------------|----------------|
| <b>Foreign currency financial assets</b> |                       |                        |                        |                         |                       |                    |                |
| Money on demand                          | 576,723               |                        |                        |                         |                       |                    | 576,723        |
| Accrued interest                         |                       | 3,197                  | 1,954                  |                         |                       |                    | 5,151          |
| Fixed term deposit                       |                       | 2,226,852              | 402,382                |                         |                       |                    | 2,629,234      |
| Holding on special drawing rights        |                       |                        |                        |                         |                       | 96,724             | 96,724         |
| Reserve tranche                          |                       |                        |                        |                         |                       | 6,253              | 6,253          |
| Subscription                             |                       |                        |                        |                         |                       | 111,963            | 111,963        |
| Gold investment                          |                       |                        |                        |                         |                       | 221,369            | 221,369        |
| Bonds                                    |                       |                        |                        | 31,195                  | 100,040               |                    | 131,235        |
| Short term                               |                       | 124,081                |                        |                         |                       |                    | 124,081        |
|  | 576,723               | 2,354,130              | 404,336                | 31,195                  | 100,040               | 436,309            | 3,902,733      |
| <b>Local currency financial assets</b>   |                       |                        |                        |                         |                       |                    |                |
| Cash on hand                             | 224                   |                        |                        |                         |                       |                    | 224            |
| Other receivables                        |                       |                        | 36,930                 |                         |                       |                    | 36,930         |
|  |                       |                        |                        |                         |                       |                    |                |
|  | On<br>Demand<br>\$000 | 0-3<br>Months<br>\$000 | 3-6<br>Months<br>\$000 | 6-12<br>Months<br>\$000 | Over<br>Year<br>\$000 | Undefined<br>\$000 | Total<br>\$000 |
| Loans and advances                       |                       |                        |                        |                         | 75,299                |                    | 75,299         |
|  | 224                   |                        | 36,930                 |                         | 75,299                |                    | 112,453        |
| <b>Total Financial Assets</b>            | 576,947               | 2,354,130              | 441,266                | 31,195                  | 175,339               | 436,309            | 4,015,186      |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

|   |             |           |           |         |         |           |           |
|---|-------------|-----------|-----------|---------|---------|-----------|-----------|
| <b>Foreign currency financial liabilities</b> |             |           |           |         |         |           |           |
| Demand deposits                               | 11,549      |           |           |         |         |           | 11,549    |
| IMF standby credit facility                   |             |           |           |         | 130,038 |           | 130,038   |
| IMF special drawing rights allocation         |             |           |           |         | 112,627 |           | 112,627   |
| IMF extended credit facility                  |             |           |           |         | 6,755   |           | 6,755     |
| IW securities                                 |             |           |           |         | 107,059 |           | 107,059   |
| Capital subscription                          |             |           |           |         | 4,930   |           | 4,930     |
|   | 11,549      |           |           |         | 361,409 |           | 372,958   |
| <b>Local currency financial liabilities</b>   |             |           |           |         |         |           |           |
| Demand deposits                               | 2,481,652   |           |           |         |         |           | 2,481,652 |
| Currency in circulation                       |             |           |           |         | 694,344 |           | 694,344   |
| SIG monetary operations account               |             | 30,215    |           |         |         |           | 30,215    |
| Fixed deposits                                |             | 610,484   | 11,245    |         |         |           | 621,729   |
| Employee entitlements                         |             |           |           |         | 13,946  |           | 13,946    |
| Other liabilities                             | 3,845       | 2,199     |           |         |         |           | 6,044     |
|   | 2,485,497   | 642,898   | 11,245    |         | 13,946  | 694,344   | 3,847,930 |
| <b>Total Financial Liabilities</b>            | 2,485,497   | 642,898   | 11,245    |         | 13,946  | 1,055,753 | 4,220,888 |
| <b>Net assets/(liabilities)</b>               | (1,920,099) | 1,711,232 | 430,021   | 31,195  | 161,393 | (619,444) | (205,702) |
| <b>Foreign currency financial assets</b>      |             |           |           |         |         |           |           |
| Money on demand                               | 732,680     |           |           |         |         |           | 732,680   |
| Accrued interest                              |             |           | 9,167     |         |         |           | 9,167     |
| Fixed term deposit                            |             | 1,329,093 | 1,036,891 | 88,551  |         |           | 2,454,535 |
| Holding on special drawing rights             |             |           |           |         |         | 103,031   | 103,031   |
| Reserve tranche                               |             |           |           |         |         | 6,029     | 6,029     |
| Subscription                                  |             |           |           |         |         | 107,949   | 107,949   |
| Gold investment                               |             |           |           |         |         | 213,073   | 213,073   |
| Bonds   |             |           |           | 32,701  | 137,673 |           | 170,374   |
| Short term                                    |             |           | 128,914   |         |         |           | 128,914   |
|   | 732,680     | 1,329,093 | 1,174,972 | 121,252 | 137,673 | 430,082   | 3,925,752 |
| <b>Local currency financial assets</b>        |             |           |           |         |         |           |           |
| Cash on hand                                  | 300         |           |           |         |         |           | 300       |
| Other receivables                             |             |           | 97,905    |         |         |           | 97,905    |
| Loans and advances                            |             |           |           |         | 81,278  |           | 81,278    |
|   | 300         |           | 97,905    |         | 81,278  |           | 179,483   |
| <b>Total Financial Assets</b>                 | 732,980     | 1,329,093 | 1,272,877 | 121,252 | 218,951 | 430,082   | 4,105,235 |
| <b>Foreign currency financial liabilities</b> |             |           |           |         |         |           |           |
| Demand deposits                               | 43,890      |           |           |         |         |           | 43,890    |
| IMF standby credit facility                   |             |           |           |         | 136,774 |           | 136,774   |
| IMF special drawing rights allocation         |             |           |           |         | 108,590 |           | 108,590   |

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

|   | On Demand<br>\$000 | 0-3 Months<br>\$000 | 3-6 Months<br>\$000 | 6-12 Months<br>\$000 | Over Year<br>\$000 | Undefined<br>\$000 | Total<br>\$000 |
|---|--------------------|---------------------|---------------------|----------------------|--------------------|--------------------|----------------|
| IMF extended credit facility                |                    |                     |                     |                      |                    | 3,257              | 3,257          |
| IW' securities                              |                    |                     |                     |                      |                    | 107,059            | 107,059        |
| Capital subscription                        |                    |                     |                     |                      |                    | 915                | 915            |
|   | 43,890             |                     |                     |                      |                    | 356,595            | 400,485        |
| <b>Local currency financial liabilities</b> |                    |                     |                     |                      |                    |                    |                |
| Demand deposits                             | 2,601,955          |                     |                     |                      |                    |                    | 2,601,955      |
| Currency in circulation                     |                    |                     |                     |                      |                    | 617,570            | 617,570        |
| SIG monetary operations account             |                    | 33,604              |                     |                      |                    |                    | 33,604         |
| Fixed deposits                              |                    | 611,932             |                     |                      |                    |                    | 611,932        |
| Employee entitlements                       |                    |                     |                     |                      | 11,009             |                    | 11,009         |
| Other liabilities                           | 7,149              | 2,253               |                     |                      |                    |                    | 9,402          |
|   | 2,609,104          | 35,857              | 611,932             |                      | 11,009             | 617,570            | 3,885,472      |
| <b>Total Financial Liabilities</b>          | 2,652,994          | 35,857              | 611,932             |                      | 11,009             | 974,165            | 4,285,957      |
| <b>Net assets/(liabilities)</b>             | (1,920,014)        | 1,293,236           | 660,945             | 121,252              | 207,942            | (544,083)          | (180,722)      |

### (c) Credit risk

Credit risk is the risk of loss arising from a counter party to a financial contract failing to discharge its obligations.

Selection of a counter party is made based on their respective credit rating. Investment decisions are based on the credit rating of the particular issuer, country limits and counter party limits in place to control exposure risks.

The Bank uses Standard and Poor's, Moody's and Fitch credit ratings for assessing the credit risk of foreign counter parties. The credit ratings of counter parties are closely monitored and are updated as new market information is available. Foreign exchange limits per bank are imposed for all currency dealings.

#### Concentration of credit exposure

The Bank's significant end-of-year concentrations of credit exposure by portfolio type were as follows:

|                                | 2014<br>\$000    | 2014<br>\$000    |
|--------------------------------|------------------|------------------|
| <b>Foreign currency assets</b> |                  |                  |
| Cash at Bank                   | 576,723          | 732,680          |
| Held to maturity investment    | 2,884,550        | 2,753,823        |
| International monetary fund    | 214,940          | 217,009          |
| Gold investment                | 221,369          | 213,073          |
|                                | <u>3,897,582</u> | <u>3,916,585</u> |
| <b>Local currency assets</b>   |                  |                  |
| Loans and advances             | 75,299           | 81,278           |
|                                | <u>3,972,881</u> | <u>3,997,863</u> |

The Bank monitors credit risk by currency and sector. An analysis of concentrations of credit risk is shown below:

| Centration by currency        | 2014             |            | 2014             |            |
|-------------------------------|------------------|------------|------------------|------------|
|                               | \$000            | %          | \$000            | %          |
| USD                           | 1,744,765        | 44         | 1,771,155        | 44         |
| AUD                           | 1,133,668        | 29         | 1,154,698        | 29         |
| EURO                          | 245,543          | 6          | 240,474          | 6          |
| SDR                           | 214,940          | 5          | 217,009          | 5          |
| NZD                           | 191,719          | 4          | 163,087          | 4          |
| SGD                           | 64,518           | 2          | 64,701           | 2          |
| STD                           | 302,426          | 8          | 305,457          | 8          |
| SBD                           | 75,299           | 2          | 81,278           | 2          |
| JPY                           | 3                | 0          | 4                | 0          |
| <b>Total financial assets</b> | <u>3,972,881</u> | <u>100</u> | <u>3,997,863</u> | <u>100</u> |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

| Centration by sector                         | 2014             |            | 2014             |            |
|--|------------------|------------|------------------|------------|
|  | \$000            | %          | \$000            | %          |
| <b>Foreign currency assets</b>               |                  |            |                  |            |
| Central banks                                | 832,039          | 23         | 1,031,968        | 28         |
| Commercial banks                             | 2,629,234        | 72         | 2,454,536        | 66         |
| International Monetary Fund                  | 214,940          | 5          | 217,009          | 6          |
|  | <u>3,676,213</u> | <u>100</u> | <u>3,703,512</u> | <u>100</u> |
| <b>Local currency assets</b>                 |                  |            |                  |            |
| Solomon Islands Government loan and advances | 68,988           | 92         | 74,883           | 92         |
| Staffloan and advances                       | 6,311            | 8          | 6,395            | 8          |
|  | <u>75,299</u>    | <u>100</u> | <u>81,278</u>    | <u>100</u> |
| <b>Total financial assets</b>                | <u>3,751,512</u> |            | <u>3,784,790</u> |            |

(d) **Market risk**

Market risk is the risk that changes in market prices, such as interest rates and foreign exchange rates

will affect the Bank's income or the value of its holding of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters while optimising the return on risk.

*Interest rate risk management*

The principal risk to which trading portfolios are exposed is the risk of loss from fluctuations in future cash flows or fair value of financial instruments because of a change in market interest rates. The Bank limits interest rate risk by modified duration targets. The duration of the portfolio is re-balanced regularly to maintain the targeted duration. Operations are largely money market focused.

At the reporting date the interest rate profile of the Bank's interest-bearing financial instruments was:

|   | 2014             | 2013             |
|---|------------------|------------------|
|   | \$000            | \$000            |
|   | Carrying amount  |                  |
| <b>Fixed rate instruments</b>                           |                  |                  |
| Held-to-maturity investments (Financial assets)         | 2,884,550        | 2,753,823        |
| Loans and advances (Financial assets)                   | 75,299           | 81,278           |
| Demand deposits (Financial liabilities)                 | (600,110)        | (369,337)        |
| SIG monetary operations account (Financial liabilities) | (16,449)         | (33,123)         |
| Fixed deposits (Financial liabilities)                  | <u>(621,729)</u> | <u>(611,932)</u> |
|   | <u>1,721,561</u> | <u>1,820,709</u> |
| <b>Variable rate instruments</b>                        |                  |                  |
| Cash at Bank (Financial assets)                         | 204,078          | 124,563          |
| International Monetary Fund (Financial liabilities)     | <u>(112,627)</u> | <u>(108,590)</u> |
|   | <u>91,451</u>    | <u>15,973</u>    |

*Fair value sensitivity analysis for fixed instruments*

The Bank does not account for any fixed rate financial assets and liabilities at fair value through profit and loss. Therefore a change in interest rates at the reporting date would not affect the profit or loss.

*Cash flow sensitivity analysis for variable rate instruments*

A change of 100 basis points (bp) in interest rates at the reporting date would have increased (decreased) equity and the profit or loss by amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

|  | Profit or loss |                |
|--|----------------|----------------|
|  | 100bp increase | 100bp decrease |
| 31 December 2014 Variable rate instruments | 915            | (915)          |
| 31 December 2013 Variable rate instruments | 160            | (160)          |

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

### Foreign exchange risk management

Exchange rate risk relates to the risk of loss of foreign reserves arising from changes in the exchange rates against the Solomon Islands dollar. The Bank has adopted a currency risk management policy, which maintains the Solomon Islands dollar value of the foreign reserves and manages the fluctuations in the revaluation reserve account. While the effect of fluctuations in foreign exchange are recorded in profit or loss, foreign exchange fluctuations are not included as part of profit distribution but transferred to the revaluation reserve for monitoring purposes.

In accordance with the CBSI Act, 2012, the task of maintaining the safety and liquidity of foreign reserve assets, as well as the returns from reserves asset management, are achieved through diversification of investment by entering into transactions in international capital and money markets. Analysis of risks is the process of managing the currency reserves by comparing factual risk levels with set limits.

The Bank's exposure to foreign exchange risk, based on carrying amounts, was as follows:

| 2014 foreign currency risk                  | USD<br>\$000     | NZD<br>\$000   | AUD<br>\$000     | EURO<br>\$000  | STG<br>\$000   | Others<br>\$000 |
|---|------------------|----------------|------------------|----------------|----------------|-----------------|
| <b>Foreign currency financial assets</b>    |                  |                |                  |                |                |                 |
| Money on demand                             | 369,385          |                | 131,087          | 72,964         | 3,284          | 3               |
| Fixed term deposit                          | 939,075          | 191,719        | 747,265          | 172,579        | 299,142        | 64,517          |
| Holding on special drawing rights           | 96,724           |                |                  |                |                |                 |
| Reserve tranche                             | 6,253            |                |                  |                |                |                 |
| Subscription                                | 111,963          |                |                  |                |                |                 |
| Gold investment                             | 221,369          |                |                  |                |                |                 |
| Bonds                                       |                  |                | 131,235          |                |                |                 |
| Short term commercial paper                 |                  |                | 124,081          |                |                |                 |
| <b>Total</b>                                | <b>1,744,769</b> | <b>191,719</b> | <b>1,133,668</b> | <b>245,543</b> | <b>302,426</b> | <b>64,520</b>   |
| <b>Foreign currency financial liability</b> |                  |                |                  |                |                |                 |
| Demand deposits                             |                  |                |                  |                |                |                 |
| IMF standby credit facility                 | 130,038          |                |                  |                |                |                 |
| IMF special drawing rights allocation       | 112,627          |                |                  |                |                |                 |
| IMF extended credit facility                | 6,755            |                |                  |                |                |                 |
| IMF securities                              | 107,059          |                |                  |                |                |                 |
| Capital subscription                        | 4,930            |                |                  |                |                |                 |
| <b>Total</b>                                | <b>361,409</b>   | <b>-</b>       | <b>-</b>         | <b>-</b>       | <b>-</b>       | <b>-</b>        |
| <b>Net foreign currency asset</b>           | <b>1,383,360</b> | <b>191,719</b> | <b>1,133,668</b> | <b>245,543</b> | <b>302,426</b> | <b>64,520</b>   |
| <b>2013 foreign currency risk</b>           |                  |                |                  |                |                |                 |
| <b>Foreign currency financial assets</b>    |                  |                |                  |                |                |                 |
| Money on demand                             | 606,852          |                | 84,641           | 39,798         | 1,269          | 120             |
| Fixed term deposit                          | 734,222          | 163,087        | 770,769          | 200,676        | 304,188        | 64,586          |
| Holding on special drawing rights           | 103,031          |                |                  |                |                |                 |
| Reserve tranche                             | 6,029            |                |                  |                |                |                 |
| Subscription                                | 107,949          |                |                  |                |                |                 |
| Gold investment                             | 213,072          |                |                  |                |                |                 |
| Bonds                                       |                  |                | 170,374          |                |                |                 |
| Short term commercial paper                 |                  |                | 128,914          |                |                |                 |
| <b>Total</b>                                | <b>1,771,155</b> | <b>163,087</b> | <b>1,154,698</b> | <b>240,474</b> | <b>305,457</b> | <b>64,706</b>   |
| <b>Foreign currency financial liability</b> |                  |                |                  |                |                |                 |
| Demand deposits                             | 34,591           |                | 9,206            |                |                | 93              |
| IMF standby credit facility                 | 136,774          |                |                  |                |                |                 |
| IMF special drawing rights allocation       | 108,590          |                |                  |                |                |                 |
| IMF extended credit facility                | 3,256            |                |                  |                |                |                 |
| IMF securities                              | 107,059          |                |                  |                |                |                 |
| Capital subscription                        | 914              |                |                  |                |                |                 |
| <b>Total</b>                                | <b>391,184</b>   | <b>-</b>       | <b>9,206</b>     | <b>-</b>       | <b>-</b>       | <b>93</b>       |
| <b>Net foreign currency asset</b>           | <b>1,379,971</b> | <b>163,087</b> | <b>1,145,492</b> | <b>240,474</b> | <b>305,457</b> | <b>64,613</b>   |

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014**

**Concentration of foreign exchange**

The Bank's net holdings of foreign exchange (excluding its holding of Special Drawing Rights) were distributed as follows as at 31 December 2014:

|      | 2014             |            | 2014             |            |
|------|------------------|------------|------------------|------------|
|      | \$000            | %          | \$000            | %          |
| USD  | 1,648,045        | 46         | 1,668,124        | 46         |
| AUD  | 1,133,668        | 32         | 1,154,698        | 32         |
| EURO | 245,543          | 7          | 240,474          | 7          |
| NZD  | 191,719          | 5          | 163,087          | 5          |
| JPY  | 3                | 0          | 4                | 0          |
| SGD  | 64,517           | 2          | 64,702           | 2          |
| STD  | 302,426          | 8          | 305,457          | 8          |
|      | <u>3,585,921</u> | <u>100</u> | <u>3,596,546</u> | <u>100</u> |

The following significant exchange rates were used at year end to convert foreign currency balances to the Solomon Island dollar equivalent.

| Reporting date spot rate |        |        |
|--------------------------|--------|--------|
|                          | 2014   | 2013   |
| AUD                      | 0.1603 | 0.1529 |
| USD                      | 0.1310 | 0.1359 |
| NZD                      | 0.1677 | 0.1663 |
| GBP                      | 0.0843 | 0.0824 |
| EURO                     | 0.1077 | 0.0986 |
| JPY                      | 15.674 | 14.290 |
| SGD                      | 0.1733 | 0.1723 |
| SDR                      | 0.0880 | 0.0913 |

|   | 2014 | 2014 |
|---|------|------|
| Sensitivity to foreign exchange rate risk   | \$M  | \$M  |
| <b>Impact of a:</b>   |      |      |
| Change in profit/equity due to a 2 per cent appreciation in the reserves - weighted value of the Solomon Islands dollar | (76) | (77) |
| Change in profit/equity due to a 2 per cent depreciation in the reserves - weighted value of the Solomon Islands dollar | 80   | 82   |

**(e) Operational risk management**

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure and from external factors other than liquidity, credit and market risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risk arises from all of the Bank's operations.

Managing operational risk in the Bank is an integral part of day-to-day operations and oversight. This includes adherence to Bank wide corporate policies. There is also an active internal audit function carried out on a quarterly basis.

Operating loss is the risk of loss from breakdown of internal controls. The Bank has established an internal audit function which will exercise monitoring and control over accounting policies and procedures, and the effective functioning of the system of internal controls at the Bank.

Operational risk relating to the activities of foreign currency reserves management is controlled by a number of internal instructions, and there is clear segregation of front office and back office activity. The latter is one of the mechanisms for managing operational risk.

**24. Fair value of financial assets and liabilities**

The fair value of an instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction. Quoted market values represent fair value when a financial instrument is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader.

*Valuation of financial instruments*

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active market for similar instruments; quoted market prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation techniques include inputs not based on observable data and the unobservable inputs have a significant impact on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

If the inputs used to measure the fair value of an asset might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The table below analyses financial instruments measured at fair value at the end of the reporting period

| 31 December 2014                           | Note | Level 1<br>\$000 | Level 2<br>\$000 | Level 3<br>\$000 | Total<br>\$000 |
|--|------|------------------|------------------|------------------|----------------|
| <i>Investment securities</i>               |      |                  |                  |                  |                |
| Available for sale financial assets (Gold) | 6    | 221,369          |                  |                  | 221,369        |
| Investment Property                        | 10   |                  |                  | 12,662           | 12,662         |
| <b>31 December 2013</b>                    |      |                  |                  |                  |                |
| <i>Investment securities</i>               |      |                  |                  |                  |                |
| Available for sale financial assets (Gold) | 6    | 213,073          |                  |                  | 213,073        |
| Investment Property                        | 10   |                  |                  | 11,935           | 11,935         |

## 25. Related parties

The Bank has related party relationships with the Board of Directors, the Executive Management and the Solomon Islands Government.

The Board of Directors during the year were:

- Denton Rarawa (Chairman and Governor)
- Gane Simbe
- Shardrach Fanega (retired from membership on 25 November 2014)
- Fred Fakarii (appointed 25 November 2014)
- Katululu Maepioh
- Loyley Ngira Lily Lomulo Tele Bartlett PrimoAfeau John Usuramo

### Directors' fees and emoluments

Amounts paid to directors during the year are disclosed in Note 4 (f). No other emoluments were paid or are due to the directors at year end.

Related party disclosures requires the disclosure of information relating to aggregate compensation of key management personnel. The key management personnel of the Bank are members of the Bank Board and senior staff who have responsibility for planning, directing and controlling the activities of the Bank. Fees of the non-executive members of the Board are determined by the Minister of Finance. The contracts of the Governor and Deputy Governor are subject to mid-term review by the Minister of Finance and annually in accordance with Bank policy. The Board of Directors determines the remuneration of the Chief Managers.

During the year the following persons were the executives identified as key management personnel, with the greatest authority and responsibility for planning and controlling the activities of the Bank:

- Denton Rarawa - Governor
- Gane Simbe - Deputy Governor
- Raynick Aquillah - Chief Manager International
- Daniel Haridi - Chief Manager Currency and Banking Operations
- Luke Forau - Chief Manager Economics Research and Statistics- on leave
- Michael Kikiolo - Acting Chief Manager Economics Research and Statistics
- Bella Simiha - Chief Manager HR and Corporate Services
- Emmanuel Gela - Chief Manager Finance and Accounts

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- Raynold Moveni - Chief Manager Financial Market Supervision
- Edward Manedika - Chief Manager Information Technology

The remuneration of the Bank's key management personnel, included in 'personnel expenses' was as follows:

|                              | 2014         | 2013         |
|------------------------------|--------------|--------------|
|                              | \$000        | \$000        |
| Short-term employee benefits | 2,490        | 3,124        |
| Long-term benefits           | 660          | 952          |
|                              | <u>3,150</u> | <u>4,076</u> |

Short-term benefits include cash salary, and in the case of staff, annual leave, motor vehicle benefits, health benefits and the fringe benefits tax paid or payable on these benefits.

Long-term benefits include long service leave and early retirement benefits.

As at 31 December 2014 loans by the Bank to key management personnel are as follows:

|                     | 2014         | 2013         |
|---------------------|--------------|--------------|
|                     | \$000        | \$000        |
| Housing Loan        | 1,032        | 1,073        |
| Personal Loan       | 105          | 106          |
| Management Car Loan | 105          | 74           |
|                     | <u>1,242</u> | <u>1,253</u> |

There were no other related party transactions with Board members; transactions with director-related entities which occurred in the normal course of the Bank's operations were conducted on terms no more favorable than similar transactions with other employees or customers.

### Transactions with the Solomon Islands Government

The transactions with the Solomon Islands Government include banking services, foreign exchange transactions, registry transactions and purchase of Government securities. During the year, the Bank received \$1.5 million (2013: \$1.7m) of interest income relating to their investments in Government securities. The Bank also paid \$3.9 million (2013: \$2.4m) to the Government in accordance with Section 34 of the CBSI Act, 2012. The balance of the Bank's investment in Government securities at year end amounted to \$68.9 million (2013: \$74.8m).

## 26. Commitments and contingent liabilities

The Bank has guaranteed staff housing loans with the commercial banks to the sum of \$0.79 million as at 31 December 2014 (2013: \$0.67m). The guarantee scheme since 2011 is no longer available to staff but is valid for eligible staff until the date of cessation of employment with the Bank.

In 2007 the Solomon Islands Government introduced and provided \$10 million for the establishment of the Small Business Finance Guarantee Scheme to be administered by CBSI. As at 31 December 2014, a total of 64 (2013: 59) loans with a net guarantee of \$6.92 million (2013: \$5.28m) have been administered under the scheme.

## 27. Events subsequent to balance date

There has not been any matter or circumstance that has arisen since the end of the financial year that has significantly affected, or may significantly affect, the operations of the Bank, the results of those operations, or the state of affairs of the Bank in future financial years.

